S. Hrg. 100-895

PROBLEMS CONFRONTING THE DOMESTIC BALL- AND ROLLER-BEARING INDUSTRY

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

PROBLEMS CONFRONTING THE DOMESTIC BALL- AND ROLLER-BEARING INDUSTRY

SEPTEMBER 8, 1988

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
90-691 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S721-5

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September 8, 1988:
- Morning session 1

PROBLEMS CONFRONTING THE BALL- AND ROLLER-BEARING INDUSTRY

THURSDAY, SEPTEMBER 8, 1988

U.S. Senate,
Committee on Small Business,
Washington, DC.

The Committee met, pursuant to notice at 9:34 a.m. in room 428A, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (Acting Chairman) presiding.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND ACTING CHAIRMAN, SENATE SMALL BUSINESS COMMITTEE

Senator **Weicker**. I am pleased that the Committee on Small Business has convened this hearing to consider the impacts of foreign competition on the domestic bearing industry. The health of the domestic industry has declined to the point that it now endangers our national security, and the administration must act now to protect this essential industry.

There can be no question about the importance of the bearing industry to our national defense. Bearings are essential to a wide range of critical military hardware including missile guidance systems, tanks and aircraft. Without a secure domestic supply of bearings, our national defense could become gridlocked.

The 1986 Defense Department Joint Logistic Commander's report found, and I quote:

> That the U.S. bearing industry, having been subject to foreign penetration of the domestic market for an extended period of time, and having suffered the natural consequences of this lost market share, is in imminent danger of being unable to support national defense needs.

It is important to realize that a viable U.S. bearing industry cannot be sustained by DOD procurement alone. Our commercial markets provide the capital needed for the investment and research to produce the critical components in military hardware. As the JLC report found, "The stability of the commodity sector of the bearing industry has deteriorated to the point where it sits upon a precipice ready to collapse. If nothing is done by the Federal Government to reduce the growing import share of the domestic market, the industry will almost withdraw from more and more markets and jeopardize the maintenance of a defense capability."

Clear evidence exists as to the troubles facing our domestic manufacturers. Over the last 10 years, the industry has lost 26 percent of its highly skilled employees. Domestic production has dropped more than 30 percent since 1978. And, as the charts on display in the committee room show, when the domestic industry's share of the consumer market drops to these levels, the problems become very obvious. Thirty-one bearing plants have closed since 1978 to be replaced by eight new ones. The New Departure Hyatt plant in Bristol, CT, once employed over 3,000 workers and is now down to 700. New Departure has just announced that another 300 jobs will be eliminated in Bristol in the near future.

Let me make very clear the fact that I am all for free trade. But when a critical industry like this gets battered on an uneven playing field, then enough is enough. We will hear testimony showing how foreign competitors are engaging in unfair trade to outcompete domestic producers. Last month the President deferred any action to help protect domestic manufacturers against imports pending further review by the Commerce Department. Enactment of this Omnibus Trade bill requires the President to make his decision by mid-November, and I can only hope that he will act in a decisive manner.

Today the Committee will hear the efforts to study and assist the U.S. bearing industry. It is a pleasure to welcome Congresswoman Nancy Johnson, who chairs the Congressional Bearing Caucus, and I look forward to hearing from the representatives of the domestic industry and hearing about the nature of foreign competition and efforts of overseas firms to gain greater U.S. market shares. For example, by estimates the Minebea Corp. of Japan has obtained an 80 percent market share of U.S. consumption of miniature and instrument sized ball bearings, which are used in sophisticated computer and aerospace equipment.

The Committee will also receive testimony from Customs Commissioner von Raab concerning his agency's role in enforcing trade and import duty laws. Representatives of the Commerce Department will inform the Committee on the status of a 232 petition to limit bearing imports to protect our national security as well as ongoing investigations into foreign companies allegedly dumping bearings into U.S. markets at unfair prices. The Defense Department is present to inform the Committee on the importance of bearings to our national defense and the implementation of new buy America acquisition regulation to assist domestic manufacturers.

Before I introduce my good friend, the Senator from New York, Senator D'Amato, who has been instrumental in bringing this issue to the Floor, I just want to recollect with the Committee and with the public an incident which occurred during my boyhood and hearing my father recount his duties as the Deputy Director of Intelligence of the 8th Air Force in World War II. He was the one that along with others, but he was in charge, that planned many of the bomber raids into Europe by the 8th Air Force. He did so because he had the intimate knowledge of Europe, of all of its nations. Indeed, three of his children, myself included, were all born in Europe, abroad.

The two most high priority targets for the 8th Air Force were the oil fields and the bearing plants. Those were the priority targets for the 8th Air Force in World War II. So, believe me, even as a youngster, I had it impressed upon me the importance of bearings for the defense of any nation, be they an importance to us, the United States, or in that case the enemy, Germany. And I think that as the saying goes, once, shame on you, twice, shame on me, and I think we have been given enough warning in the sense of the evidence that I have already seen prior to these hearings to know that we have got a bearing industry that is in jeopardy and, as a result a national defense posture that is in jeopardy.

Senator D'Amato.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. Mr. Chairman, thank you for your gracious introduction. Let me say, if I might borrow from your last remarks, that the bearing industry today is as important if not more so to our national defense than it was during World War II. It is critical to this Nation that we maintain a viable ball bearing industry. More importantly, we must look at the state of the bearing industry and how it has reached a condition where in some cases, as you have mentioned, a foreign company from Japan controls 80 percent—a very significant share—of ball bearing production and sales in this country.

Mr. Chairman, I have a very lengthy statement that I am going to submit for the record and I would ask that it be printed as if read in its entirety. Now, we can begin to listen to our various witnesses and Congresswoman Johnson in particular, but before we do, I would like to touch on three things. First, there have been many who have come forward and have made rather specific allegations that bearings have been brought in which are foreign produced and yet they are being stamped as made in U.S.A. or sold as being produced here in this country. If that is the case, it is illegal and not only is it illegal under civil law to hold out that these bearings are being made here in the United States, but it is criminal. It is about time that we had law enforcement in this area. It is time that the Justice Department got off its duff and did something instead of allowing this kind of thing to languish.

There is no reason for these illegal acts which have been alleged. Evidence which has been gathered will probably take more than 2 years to produce indictments. Until then, we face a continuing violation, if these allegations are correct, harming of the national security of this country. I am tired, to be quite candid with you of having these kinds of things take place. After years and years of investigation, when we finally get a conviction, we get from the other side, "So sorry, we will not do it again," and the American businessman is destroyed. In the meantime, our national security is jeopardized and the question as to whether or not we can ever compete again in this area has never been answered.

Not to mention, Mr. Chairman, as you have stated, we face the destruction of thousands and thousands of American jobs, the negative impact on communities throughout the length and breadth of this Nation, and the unfair nature of the competition. That is one aspect.

As it relates to unfair competition, there is no doubt in this Senator's mind that the Japanese government has been helping certain industries that have been dumping bearings for sale in the United States unfairly. This administration has not done what it should as far as I am concerned in this case.

And my third point, there are allegations that there has been substitution of materials and falsification of the grades of imported bearings in order to compete unfairly with those which are manufactured in the United States. Mr. Chairman, if these accusations have any semblance of truth, and I believe that they do, and we are restricted from more specific discussion as a result of an ongoing investigation, I would say that enforcement has taken too long. By delaying the completion of this investigation, we delay justice.

If anything, I hope that calling these hearings would encourage those who are in charge of these investigations to finish them, to reach to a conclusion. I believe when the evidence has been compiled and is reviewed, that there will be presentations to a grand jury. I hope that those who are responsible get more than a mere slap on the wrist.

I do not know how you compensate for the loss of American workers' jobs. I do not know how you compensate for the falsification of bearing grades and use of substandard materials in bearings that reach the marketplace, but we will leave those questions for another time and maybe another venue.

So, I congratulate you, Mr. Chairman, for holding these hearings.

[The prepared statement of Senator D'Amato follows:]

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SENATOR ALFONSE D'AMATO
OPENING STATEMENT
SMALL BUSINESS COMMITTEE HEARING ON
U.S. BALL BEARING INDUSTRY PROBLEMS

MR. CHAIRMAN:

IN 1942, THE UNITED STATES ARMY AIR FORCE LAUNCHED A MAJOR STRATEGIC BOMBING RAID ON SCHWEINFURT. WE LOST MANY PLANES AND AIRCREWMEN IN THIS ATTACK AGAINST A VERY HEAVILY DEFENDED TARGET -- BUT NEARLY KNOCKED THE NAZIS OUT OF WORLD WAR TWO.

WHAT TARGET WAS WORTH LOSING THESE PLANES AND MEN? THE GERMAN BALL BEARING FACTORIES. THAT RAID AND ITS SUCCESSORS DESTROYED A SUBSTANTIAL PART OF THE GERMAN BALL BEARING INDUSTRY.

SINCE 1979, THE UNITED STATES HAS LOST 26% OF THE JOBS IN THE DOMESTIC BALL BEARING INDUSTRY, AND 19% OF ITS BALL BEARING MANUFACTURING PLANTS, AND PRODUCTION CAPACITY HAS DECLINED ACCORDINGLY. IF THIS HAD BEEN THE RESULT OF ENEMY ATTACK, IT WOULD BE VIEWED AS THE GRAVEST THREAT TO OUR NATIONAL SECURITY.

WHAT HAPPENED TO THAT CAPACITY? IT WAS LOST TO FOREIGN COMMERCIAL ATTACK, NOT MILITARY ATTACK. THE FOREIGN NATION GAINING THE MOST FROM THE PROCESS WAS JAPAN. WHILE NO BOMBERS DISPLAYING THE RISING SUN INSIGNIA APPEARED OVER NEW

YORK, CONNECTICUT, ARKANSAS, SOUTH CAROLINA, PENNSYLVANIA, ILLINOIS, MASSACHUSETTS, OHIO, NEW HAMPSHIRE, OR NEW JERSEY, THE BALL BEARING PLANTS IN THOSE STATES DISAPPEARED JUST AS THOUGH THEY HAD BEEN BLASTED FROM THE FACE OF THE EARTH.

INSTEAD OF DROPPING BOMBS, THE JAPANESE WERE DROPPING PRICES. AT THIS MORNING'S HEARING, WE WILL HEAR TESTIMONY ABOUT THE LARGEST JAPANESE MINIATURE BEARING MANUFACTURER, MINEBEA, AND ITS PREDATORY AND ALLEGEDLY ILLEGAL TACTICS. THIS COMMITTEE HAS IN ITS POSSESSION DOCUMENTS FROM THAT JAPANESE COMPANY OBTAINED IN A RAID BY THE U.S. CUSTOMS SERVICE ON ITS WHOLLY-OWNED CALIFORNIA SUBSIDIARY, A COMPANY CALLED NIPPON MINIATURE BEARINGS, SHOWING A PATTERN OF ACTIVITIES DESIGNED TO TAKE OVER THE U.S. MINIATURE BALL BEARING MARKET.

THE VICTIMS OF THIS JAPANESE COMMERCIAL IMPERIALISM HAVE BEEN U.S. COMPANIES AND U.S. WORKERS. SINCE 1979, THE U.S. BALL BEARING INDUSTRY HAS LOST NEARLY 15,000 JOBS AND APPROXIMATELY $11 BILLION IN SALES. 31 BEARING AND BEARING PARTS PLANTS HAVE CLOSED, DEVASTATING COMMUNITIES FROM NEW HAMPSHIRE TO ARKANSAS.

NOW, WE HAVE REASON TO BELIEVE THAT SOME OF MINEBEA'S ACTIVITIES MAY HAVE ENDANGERED THE LIVES OF U.S. SERVICE MEN

AND WOMEN AROUND THE WORLD AND MAY HAVE UNDERMINED OUR ABILITY TO DEFEND THIS COUNTRY AGAINST ATTACK.

THE DEPARTMENT OF DEFENSE PURCHASES A LARGE NUMBER OF WEAPONS SYSTEMS THAT CONTAIN BALL BEARINGS. MINEBEA'S CALIFORNIA SUBSIDIARY, NIPPON MINIATURE BEARINGS, SOLD BEARINGS TO THE DEFENSE DEPARTMENT AND PROBABLY TO MANY DEFENSE CONTRACTORS. THIS IS INDICATED ON THE RETURN OF THE MAY 27, 1988 SEARCH WARRANT, WHICH LISTS APPROXIMATELY 60 DEFENSE LOGISTICS AGENCY CONTRACT FILES AMONG THE ITEMS SEIZED.

SINCE THERE IS AN ACTIVE DEFENSE CRIMINAL INVESTIGATIVE SERVICE INVESTIGATION OF NIPPON MINIATURE BEARING'S ACTIVITIES UNDERWAY, I WILL NOT GO INTO THE SPECIFICS OF WHAT THE INVESTIGATORS FOUND.

WHY IS THIS IMPORTANT? THOSE BEARINGS GO INTO SYSTEMS LIKE FIGHTER AIRCRAFT, NAVIGATION SYSTEMS, GUIDANCE SYSTEMS, FLIGHT CONTROL SYSTEMS, AND OTHER CRITICAL PIECES OF EQUIPMENT UPON WHICH PEOPLE'S LIVES -- AND THE DEFENSE OF THE UNITED STATES -- DEPEND.

MR. CHAIRMAN, PEOPLE MAY THINK THAT BALL BEARINGS ARE NO LONGER IMPORTANT IN A COMPUTERIZED WORLD OF AEROSPACE PLANES

AND STRATEGIC DEFENSE SYSTEMS. NOTHING COULD BE FARTHER FROM THE TRUTH.

LET ME BRIEFLY TELL A STORY THAT I KNOW MOST OF MY COLLEAGUES HAVE HEARD BEFORE. IT'S ABOUT MINIATURE BALL BEARING MACHINES.

IN THE LATE 1960'S, THE UNITED STATES DEVELOPED A WAY TO PUT MORE THAN ONE WARHEAD ON ITS INTERCONTINENTAL BALLISTIC MISSILES, AND TO AIM EACH OF THESE WARHEADS AT A DIFFERENT TARGET. THIS TECHNIQUE IS CALLED "MIRVING" A MISSILE -- PUTTING "MULTIPLE INDEPENDENTLY-TARGETED RE-ENTRY VEHICLES" ON IT.

THE KEY TO "MIRVING" ICBMS AND SUBMARINE LAUNCHED BALLISTIC MISSILES WAS THE DEVELOPMENT OF THE "POST-BOOST VEHICLE" OR WARHEAD "BUS," AS IT IS POPULARLY CALLED. THE WARHEADS RIDE ON THIS BUS, WHICH IS THE LAST OR TOP STAGE OF THE MISSILE.

WHERE DO BALL BEARINGS COME IN? EACH WARHEAD ON TOP OF THE BUS SITS ON TOP OF SOMETHING LIKE A PHONOGRAPH TURN-TABLE. JUST BEFORE EACH WARHEAD IS RELEASED AT THE COMMAND OF THE MISSILE'S GUIDANCE SYSTEM TO FOLLOW ITS OWN PATH TO ITS SELECTED TARGET, THIS TURN-TABLE IMPARTS A VERY

PRECISE SPIN TO THE WARHEAD. THIS IS IMPORTANT TO ITS ACCURACY.

THE TURN-TABLE TURNS ON MINATURE PRECISION BEARINGS OF A VERY SPECIAL KIND. WITHOUT THE ABILITY TO MAKE THOSE BEARINGS, YOU CAN'T MAKE AN ACCURATE MIRVED ICBM OR SLBM.

YOU ALL KNOW THE END OF THIS STORY. WHEN DETENTE WAS FIRST IN FLOWER, THE UNITED STATES AGREED TO SELL PRECISION BALL BEARING MANUFACTURING EQUIPMENT TO THE SOVIET UNION. THIS DECISION WAS TAKEN OVER THE PROTESTS OF THE DEFENSE DEPARTMENT.

THE BALL BEARINGS PRODUCED BY THESE MACHINES MADE IT POSSIBLE FOR THE SOVIET UNION TO DEVELOP ITS HEAVY, MIRVED ICBMS AND SLBMS, PRODUCING THE CURRENT UNSTABLE STRATEGIC SITUATION. WITHOUT THOSE BALL BEARINGS, THE SOVIETS WOULD NOT HAVE BEEN ABLE TO BUILD MIRVED MISSILES ACCURATE ENOUGH TO DESTROY OUR MINUTEMAN MISSILE SILOS, PUTTING AT RISK OUR ABILITY TO INFLICT OVERWHELMING DAMAGE TO THE SOVIET UNION IN A SECOND STRIKE.

BUT FOR THOSE BALL BEARING MACHINES, WE MIGHT NOT HAVE NEEDED THE MX MISSILE, THE TRIDENT II MISSILE, OR EVEN THE STRATEGIC DEFENSE INITIATIVE, BECAUSE THEY ARE ALL NECESSARY

RESPONSES TO THE THREAT POSED TO OUR STRATEGIC FORCES BY THOSE MIRVED SOVIET MISSILES.

THAT IS HOW IMPORTANT THESE BALL BEARINGS -- AND THE ABILITY TO MAKE THEM -- ARE IN THE MODERN WORLD. OUR NATIONAL SURVIVAL LITERALLY DEPENDS UPON THEM. AND THE JAPANESE ARE GAINING MARKET SHARE, RISING TO THE POINT WHERE MINEBEA MAY CONTROL AS MUCH AS 80% OF ONE IMPORTANT SECTOR OF OUR MARKET. IF THIS CONTINUES, IT COULD DESTROY OUR DOMESTIC BALL BEARING INDUSTRY.

MR. CHAIRMAN, THERE ARE TWO PENDING ACTIONS WITHIN THE EXECUTIVE BRANCH THAT COULD OFFER SOME PROTECTION FOR THE U.S. BALL BEARING INDUSTRY. ONE WAS A PETITION FILED BY THE ANTI-FRICTION BEARING MANUFACTURERS ASSOCIATION IN JULY, 1987, UNDER SECTION 232 OF THE TRADE EXPANSION ACT OF 1962 ON NATIONAL SECURITY GROUNDS. IT ASKED THAT QUOTAS BE IMPOSED ON IMPORTS OF BEARING PRODUCTS.

ON AUGUST 10, 1988, THE WHITE HOUSE ANNOUNCED THAT IT WOULD NOT TAKE ACTION ON THAT PETITION BEFORE JANUARY OF 1989, BECAUSE IT WANTED TO WAIT AND SEE WHAT EFFECT NEWLY PUBLISHED DEFENSE ACQUISITION REGULATIONS REQUIRING THE PURCHASE OF U.S. MADE BALL BEARINGS WOULD HAVE.

THE OTHER IS A PETITION UNDER SECTION 301. IT ALLEGES THAT THE JAPANESE ARE DUMPING BALL BEARINGS HERE. IT IS NOW BEFORE THE DEPARTMENT OF COMMERCE AND THE INTERNATIONAL TRADE COMMISSION FOR ACTION.

WE HAVE BEFORE US TODAY A DISTINGUISHED GROUP OF WITNESSES WELL ABLE TO SPEAK TO ALL ASPECTS OF THIS SITUATION. WE HAVE TWO DOMESTIC BALL BEARING MANUFACTURERS AND THE DISTINGUISHED CO-CHAIR OF THE CONGRESSIONAL BALL BEARING CAUCUS, WHO CAN TELL US WHAT HAS HAPPENED TO THE U.S. BALL BEARING INDUSTRY -- AND WHY. WE HAVE THE COMMISSIONER OF CUSTOMS WHO CAN TESTIFY, WITHIN THE LIMITS PERMITTED BY A CONTINUING FEDERAL CRIMINAL INVESTIGATION, REGARDING THAT CASE, AND REGARDING HIS ENFORCEMENT EFFORTS GENERALLY. AND WE HAVE REPRESENTATIVES OF THE DEPARTMENTS OF DEFENSE AND COMMERCE WHO CAN SPEAK TO THE NATIONAL SECURITY IMPERATIVE OF PRESERVING THE DOMESTIC BALL BEARING INDUSTRY -- AND TO WHAT HAS ACTUALLY BEEN DONE TO ACHIEVE THAT VITAL GOAL.

MR. CHAIRMAN, I LOOK FORWARD TO THE OPPORTUNITY TO HEAR FROM THESE DISTINGUISHED WITNESSES. I AM CERTAIN THAT WHAT THEY WILL TELL US WILL SERVE AS A CALL TO ACTION TO EVERYONE CONCERNED ABOUT OUR NATIONAL SECURITY AND OUR INDUSTRIAL COMPETITIVENESS.

THANK YOU.

Senator **Weicker**. Thank you very much, Senator D'Amato.

Senator D'Amato has raised a point that I think should be clear at the outset. This Committee, Senator D'Amato, myself, are aware of ongoing investigations. As Senator D'Amato has said, investigations involving illegal conduct, criminal conduct. It is not the intention nor will I permit these hearings to take any turn which would jeopardize those investigations and whatever subsequent action follows.

I think that everybody would understand, then, that there are certain matters, as much as I would like to see them fully developed with public knowledge, that cannot be so at this time. But I think the flavor of the matters that have been alluded to will certainly come across during the course of witness testimony.

Now, just before introducing my good friend Nancy Johnson, I would like to read a letter and a statement from a Member of the U.S. Senate and of the State Justice Commerce Subcommittee on Appropriations, Warren Rudman. Senator Rudman states: "I regret that a prior commitment precludes me from participating directly in the hearing today on the Ball Bearing Industry. The subject is an important one to me because a major bearing production firm is in my State, and so I would appreciate very much the attached statement be read by you or the Acting Chairman as my opening comments before the first witness is called. Thank you for your assistance, Warren Rudman."

"Mr. Chairman, the subject of today's hearing is an important one, as it is indisputable that the bearing industry plays a key role in the national defense production. I have a particular interest in this subject because of the presence in my State of a major bearing production firm which has long been a major supplier to the Department of Defense.

"I doubt the story of New Hampshire Ball Bearings is familiar to my colleagues, but it bears directly on this hearing. For decades New Hampshire Ball Bearings had difficulty making the capital and technological improvements required to keep it competitive. By the mid-1980's the fortunates of the company had deteriorated to the point that its continued existence was in question. The State was fortunate that Minebea was willing to make a commitment to make the resources available to make it competitive again.

"Since 1985 Minebea has transformed and revived what had been a declining company with aging equipment and plants in Peterboro, Linconia, and Jaffrey, NH, with an infusion of new capital equipment of $28 million and $5 million of addition equipment on order, the company now boasts a state-of-the-art plant, state of employment of over 1,300 and a promising future based on military and commercial sales and growing exports. The plant contributes an estimated $54 million annually to the State's economy.

"The chairman of New Hampshire Ball Bearings is a good corporate citizen of my State, I believe it is a positive example of an international partnership should be kept in mind by the committee during this hearing."

Senator **Weicker**. And that will be entered into the record at this point.

[The prepared statements of Senators Rudman and Dixon follow:]

STATEMENT OF SENATOR WARREN B. RUDMAN

Mr. Chairman, the subject of today's hearing is an important one, as it is indisputable that the bearing industry plays a key role in our national defense production. I have a particular interest in this subject because of the presence in my state of a major bearing production firm, which has long been a major supplier to the Department of Defense.

I doubt the story of New Hampshire Ball Bearing is familiar to my colleagues, but it bears directly on this hearing. For decades, New Hampshire Ball Bearing had difficulty making the capital and technological improvements required to keep it competitive. By the mid-1980's, the fortunes of the company had deteriorated to the point that its continued existence was in question. The state was fortunate that Minebea was willing to make the commitment and make the resources available to make it competitive again.

Since 1985, Minebea has transformed and revived what had been a declining company with aging plants and equipment in Peterborough, Laconia and Jaffrey, New Hampshire. With an infusion in new capital equipment of $28 million, with $5 million of additional equipment on order, the company now boasts a state of the art plant, a stable employment of over 1,100, and a promising future based on military and commercial sales and growing exports. The plant contributes an estimated $54,000,000 annually to the state's economy.

Mr. Chairman, New Hampshire Ball Bearing is a good corporate citizen of my state. I believe this positive example of an international partnership should be kept in mind by the committee during this hearing.

SEPTEMBER 8, 1988

STATEMENT BY SENATOR ALAN J. DIXON

COMMITTEE ON SMALL BUSINESS

HEARING ON THE IMPACTS OF FOREIGN COMPETITION UPON THE DOMESTIC BEARING INDUSTRY

MR. CHAIRMAN, I WANT TO THANK YOU FOR HOLDING THIS HEARING ON THE BEARING INDUSTRY. THE EXTENT TO WHICH OUR DOMESTIC PRODUCERS OF BALL AND ROLLER BEARINGS ARE BEING HURT BY FOREIGN DUMPING IS OF REAL CONCERN.

BEARINGS ARE AN IMPORTANT PART OF ALMOST EVERY PIECE OF EQUIPMENT, FROM GIANT EARTH MOVERS TO SENSITIVE DEFENSE ARMAMENTS. NO ONE CAN DENY THAT WE NEED A STABLE, UNINTERRUPTABLE SUPPLY OF THESE COMPONENTS. THIS IS ESPECIALLY TRUE WHEN THE COMPONENTS ARE NECESSARY TO SUPPORT OUR DEFENSE SYSTEMS. I HAVE EXPRESSED MY CONCERN ABOUT THE DECLINE IN OUR DEFENSE INDUSTRIAL BASE ON MANY OCCASIONS. LAST YEAR I INTRODUCED A BILL WHICH WOULD SPECIFICALLY PROTECT AND STRENGTHEN DOMESTIC MANUFACTURERS OF VITAL DEFENSE PARTS. IN A TIME OF WAR, OR SIMPLY IN A TIME OF ECONOMIC CONFLICT, WE MUST BE ABLE TO QUICKLY RESPOND TO NATIONAL NEEDS. WE CANNOT AFFORD TO GET OURSELVES INTO A POSITION OF TOTAL RELIANCE ON FOREIGN SUPPLIERS. OUR ABILITY TO SUSTAIN OURSELVES IS AT STAKE. I REMAIN CONCERNED FOR THE WELL BEING OF OUR DEFENSE INDUSTRIAL BASE.

HAVING SAID THAT, HOWEVER, I RECOGNIZE THAT THE BULK OF BALL AND ROLLER BEARINGS USED IN THIS COUNTRY ARE INCORPORATED INTO NON-DEFENSE EQUIPMENT. DOMESTIC EQUIPMENT MANUFACTURERS NEED READY ACCESS TO REASONABLY PRICED, HIGH QUALITY GOODS. OUR ABILITY TO BE COMPETITIVE WORLDWIDE DEPENDS ON IT. WITH CHANGES IN THE VALUATION OF THE DOLLAR WITH RESPECT TO OTHER CURRENCIES, OUR MANUFACTURERS ARE IN A BETTER POSITION TO EXPORT THEIR GOODS THAN IN RECENT MEMORY. THESE EXPORTS HAVE CONTRIBUTED TOWARDS THE REDUCTION OF OUR TRADE DEFICIT AND THE CONTINUATION OF OUR ECONOMIC RECOVERY. WE MUST TAKE CARE THAT ANY ACTION TAKEN WITH RESPECT TO FOREIGN PRODUCERS OF BALL AND ROLLER BEARINGS DOES NOT PENALIZE OUR DOMESTIC EQUIPMENT MANUFACTURERS.

THE IMPOSITION OF QUOTAS ON BALL OR ROLLER BEARINGS AT THIS POINT IN TIME WOULD, ACCORDING TO A MAJOR CONSTITUENT OF MINE, HAVE SUCH A NEGATIVE EFFECT. I AM INFORMED THAT THERE IS A SHORTAGE OF BEARINGS NOW, AND THAT DOMESTIC BEARING PRODUCERS ARE PRODUCING AT OR CLOSE TO CAPACITY. DOMESTIC EQUIPMENT MANUFACTURERS MUST WAIT TO RECEIVE THEIR ALLOCATION OF BEARINGS IN ORDER TO FINISH ASSEMBLY OF THEIR PRODUCTS. IF THIS CONTINUES, WE WILL LIKELY LOSE BUSINESS TO OTHER FOREIGN MANUFACTURERS OF EQUIPMENT AND WE WILL EXPERIENCE AN UNFORTUNATE AND UNNECESSARY DECREASE IN OUR EXPORTS.

DOMESTIC BEARING MANUFACTURERS ALREADY HAVE AT THEIR DISPOSAL OTHER IMPORTANT PROTECTIONS SUCH AS ANTI-DUMPING DUTIES AND GOVERNMENT PROCUREMENT PREFERENCES. I AM SURE THAT TODAY'S TESTIMONY WILL ADDRESS TO SOME DEGREE THE EFFECTIVENESS OF THESE REMEDIES. BUT, I HOPE THAT THE COMMITTEE WILL LOOK AT THE IMPACT ALL ACTIONS TAKEN AGAINST FOREIGN BEARING MANUFACTURERS, FROM THE PERSPECTIVE OF DOMESTIC USERS AS WELL

AS DOMESTIC PRODUCERS. TO THAT END I ASK UNANIMOUS CONSENT THAT THE COMMENTS OF ONE SUCH USER FROM MY HOME STATE BE INCLUDED IN THE RECORD.

I LOOK FORWARD TO HEARING TESTIMONY FROM TODAY'S PARTICIPANTS ON THIS ISSUE OF IMPORTANCE.

COMMENTS BY STEVEN C. HOFFMAN
CATERPILLAR INC.
IN CONNECTION WITH HEARINGS OF THE SENATE COMMITTEE ON SMALL BUSINESS
SEPTEMBER 8, 1988

Caterpillar Inc. is a multinational company, and one of America's largest exporters, which manufactures earthmoving, construction and materials handling machinery and equipment, and engines. In 1987, Caterpillar's worldwide sales were nearly $8.2 billion, and it employed over 54,000 workers, 37,000 of which were located in the United States. Caterpillar is also a very substantial consumer of antifriction bearings, and in 1987 it purchased over $50 million of such bearings.

Caterpillar is a significant supplier of machinery and equipment to the U.S. Department of Defense. Over the last few years, Caterpillar has made sales of several hundred million dollars to DoD. These sales are in addition to the many hundreds of millions of dollars in indirect military sales of merchandise utilized by Caterpillar's private sector customers to meet DoD contracts. In time of mobilization, construction equipment and engines such as that supplied by Caterpillar are in great demand. They make possible the rapid expansion of plants for producing war material and the expansion and construction of military facilities. In combat, construction equipment is used in the building of roads, air fields, and other facilities right up to the front lines.

Caterpillar is deeply concerned that restrictions on its ability to source bearings worldwide could jeopardize Caterpillar's ability to supply these critical products needed by DoD, thereby harming the national security of the United States.

While restrictions on the importation of antifriction bearings may result, over the long term, in some increase in U.S. bearing production, it would undermine the competitiveness of engine, vehicle and heavy equipment manufacturing in the United States. Import restrictions would compromise the ability of the industrial base to respond to defense needs, even in peacetime.

Ironically, U.S. bearings would continue to remain hostage to possible interdiction of trade in the event of hostilities even if the U.S. became totally self-sufficient in bearings, because most bearing steel is imported.

In addition to the foregoing, a critical shortage of antifriction bearings currently exists in the United States as a result of the boom in heavy manufacturing and the weakening of the U.S. dollar. Any import restrictions on antifriction bearings can only exacerbate this situation. For example, because of the unavailability of replacement parts, numerous Caterpillar machines owned by customers are literally "down" in the field awaiting bearings. This is affecting not only Caterpillar replacement parts sales, but will ultimately cause Caterpillar to lose machine sales to dissatisfied customers who will opt for machines not using domestic bearings. Also, the inability of domestic bearing suppliers to timely supply certain bearings to Caterpillar is threatening Caterpillar's assembly lines and disrupting Caterpillar's production schedules for machines using those bearings.

In order to avoid the shutdown of assembly lines, Caterpillar at times has had to air freight foreign bearings to its U.S. manufacturing plants at substantial price premiums.

Additional restrictions on the importation of antifriction bearings would be an unwise policy decision that would hurt, not help, the U.S. industrial base and national security. The U.S. bearing industry has already received relief through the imposition of DoD procurement restrictions. In addition, an antidumping duty order is currently outstanding against certain tapered roller bearings, and an antidumping investigation is currently ongoing involving most antifriction bearings other than tapered roller bearings. All of the foregoing will aid the U.S. bearing industry. Should it be necessary to further assist domestic bearing producers, the appropriate and most efficient way to achieve this objective is through direct government financial assistance under the various government programs already in place, including government funded research and development of materials and products and plant modernization programs. The domestic bearing industry must not be aided at the expense of domestic consumers of bearings.

Mr. Chairman, we request that a copy of our statement to the International Trade Commission on bearings be included in the hearing record with this statement.

Statement of Michael Dykstra On behalf of Caterpillar Inc., before the Staff of the International Trade Commission

April 21, 1988

My name is Michael Dykstra. I am employed by Caterpillar Inc. as a buyer of antifriction bearings. I have been with Caterpillar for about 24 years.

I appear here today in opposition to the petition which seeks the imposition of additional duties on antifriction bearings, other than tapered roller bearings. We are particularly concerned with market conditions in the United States for bearings which we purchase in substantial quantities from petitioner Torrington as well as other domestic and foreign suppliers.

Caterpillar is a manufacturer of earth moving products, construction and materials handling equipment, engines and turbines in 15 plants in the United States, and through a variety of arrangements, in 15 facilities abroad. In 1987 Caterpillar had worldwide sales of $8.2 billion, of which U.S. sales were $4.3 billion, and foreign sales were $3.9 billion. Caterpillar employed over 54,000 people at year end 1987, of which about 37,000 worked at U.S. facilities. During 1987 the company's exports produced a net favorable contribution of $1.05 billion to the U.S. balance of payments.

As the Commission may know from our previous appearances before you, Caterpillar has been struggling in recent years to regain its competitive position throughout the world in the face of fierce international competition. The company returned to profitability in 1985, after three years of very severe losses, and improved its sales and profits again in 1987. This turn-around has in large measure been as the result of a massive cost reduction program begun in 1982 which has resulted in the closing of facilities both at home and abroad, including three plant shut downs in 1987, and forced reductions in the workforce of about 36,000 worldwide, 20,000 of them in the U.S.

However Caterpillar's competitors have taken similar cost reducing actions. The competitive situation requires us to cut costs an additional 10% by 1991.

It is in this competitive environment that Caterpillar seeks to prevent constriction of its component supplies, which inevitably translates into higher costs. If Caterpillar is to maintain its U.S. manufacturing base, while remaining competitive in world markets with foreign producers, we cannot pay more for our components - such as antifriction bearings - than our competitors do.

In 1987 Caterpillar purchased over $20 million worth of antifriction bearings (excluding tapers) from all sources, the majority from domestic producers. This includes cylindrical roller bearings, needle roller bearings, spherical roller and spherical plain bearings, ball bearings and others. The current situation with regard to ball bearings is of particular concern to Caterpillar and we urge that the Commission examine the supply and demand for this merchandise with great care.

There is serious doubt that domestic producers of antifriction bearings are able to supply the needs of U.S. industrial consumers. Within the past several months it has become even more apparent that existing domestic facilities, particularly those of the petitioner Torrington/Fafnir, cannot meet current demand for commercial ball bearings in a marketplace that is presently open to imports. Fafnir is falling further and further behind in its deliveries, causing severe problems for Caterpillar, its dealers and customers. Because of the unavailability of replacement parts from Fafnir, numerous Caterpillar machines in the field are literally "down", awaiting ball bearings. This is affecting not only Caterpillar replacement parts sales, but will ultimately cause Caterpillar to lose machine sales to dissatisfied customers who will opt for machines which do not use domestic bearings. Also, the inability of Torrington/Fafnir to timely supply ball bearings to Caterpillar is disrupting Caterpillar's production schedules for machines using those bearings. Any additional constriction in the supply of ball bearings, such as would result from the imposition of import restraints on bearings would be catastrophic for Caterpillar machine and parts sales and manufacturing operations, and for the industries which depend on Caterpillar machinery.

This situation is best illustrated by Torrington/Fafnir's dismal record in delivering ball bearings to Caterpillar's Morton, Ill. Parts Department, which is the central distribution facility for replacement bearings sold worldwide through Caterpillar dealers. As of December 1987, at Morton all 94 individual open ball bearing orders from Torrington/Fafnir were between 3 and 12 months behind schedule. As of March 7, 1988, 52 of those orders were still undelivered, some with promised delivery dates now moved as far forward as December 1988. These broken promises make it extremely difficult for Caterpillar to rely on Fafnir as a dependable supplier.

Clearly this is an intolerable situation, which is getting worse as Torrington/Fafnir's deliveries have grown increasingly delinquent since June 1987. We will submit detailed confidential information showing this delinquency with our post-conference brief. In order to prevent additional down-time of Caterpillar produced machinery and disruption of its U.S. manufacturing operations, the company is seeking additional sources for these bearings, on an expedited basis.

This inability by petitioner to meet delivery schedules has apparently been caused by the closing of one of Fafnir's plants and the imminent shut down of another, leaving Fafnir with insufficient ball bearing capacity to meet its present commitments. At the same time Fafnir is drastically reducing capacity, its principal domestic competitor, Federal Mogul is in the process of opening a new ball-bearing facility which, we understand will be technologically advanced but which may only replace existing, out-of-date capacity.

We note that while domestic capacity is apparently shrinking, imports of ball bearings have been relatively flat for the past 3 years, and in quantity terms, in 1987, actually declined both absolutely and as a percentage of apparent domestic consumption. Thus the cause of any recent change in petitioner's capacity must be attributable to causes other than imports.

Let me just note briefly that we believe it is inappropriate to treat all antifriction bearing producers, other than those making tapered roller bearings as a single industry, or to consider all such bearings as a single "like product." There are separate producers for most types of bearings - with some overlap - but no producer makes roller bearings and ball bearings interchangeably on the same machinery. Furthermore engineers agree that it is ludicrous to suggest that bearings of different types are readily substitutable.

Certain bearings are required to perform certain mechanical tasks, and the limitations imposed by dimension and capacity constraints dictate which bearing must be used for a specific application. Thus in Caterpillar's planetary transmissions, needle, ball and cylindrical bearings are the only types considered. Each is used separately for a specific application but there is no way that the ball bearings which are needed for alignment, not load carrying, could be used in place of the needle bearings, which have high load bearing capacity for a small envelope size.

The Commission must bring some order to this proceeding by treating ball bearings, and several of the other bearings petitioner seeks to lump together, as discrete industries and products. The Commission's past treatment of the producers of tapered roller bearings as a separate industry was a recognition of reality and provides a precedent for this action. We will address this issue in more detail in our post-conference brief.

Product availability and quality is more important to Caterpillar than simple price since product availability is a critical element of cost. Petitioner is not now a reliable supplier of ball bearings. To compound this unreliablity Fafnir informed us in mid March that their ball bearing prices were to be increased by an average of 60% on May 1, 1988. In some instances individual parts have been increased by up to 400 percent. These increases are on products some of which are a year late in delivery. The petitioner is clearly in grave difficulty, but there appears to be little evidence that imposing additional duties on imports will resolve these difficulties since Fafnir is unable to meet current demand and has imposed massive price increases prior to any action to restrict imports.

In conclusion, Caterpillar is committed to remaining internationally competitive. That competitiveness cannot be maintained from a U.S. manufacturing base if production of key components is dependent upon unreliable, high-cost suppliers. Shrinkage of the U.S. manufacturing sector, as companies like Caterpillar either lose business to lower-cost foreign manufacturers or are forced to move production off-shore will not solve petitioner's problems.

The global competitive conditions for Caterpillar's finished products leave the company no choice but to require that its suppliers be competitive on a world-wide basis. It is this environment, coupled with the structural problem of the domestic industry which have resulted in domestic manufacturers turning to imports for a portion of their bearing needs, not any alleged LTFV sales by foreign suppliers. Caterpillar's cost reduction program will continue one way or another regardless of the Commission's determination in this investigation. Whatever adverse effects petitioner may have suffered because of its customers' cost containment efforts cannot be addressed by the imposition of additional duties on these products.

Thank you.

COMMENTS ON BEHALF OF CATERPILLAR INC. IN CONNECTION WITH NATIONAL SECURITY INVESTIGATION OF ROLLER & BALL BEARING IMPORTS

Introduction

These comments are submitted on behalf of Caterpillar Inc., a purchaser of imported and domestically produced antifriction bearings of all kinds, including ball and tapered roller bearings, headquartered in Peoria, Illinois, in response to the petition of the Anti-Friction Bearing Manufacturers' Association under Section 232 of the Trade Expansion Act of 1962.[1] Caterpillar Inc. is a multinational company which designs, manufactures, and markets products in two principal categories: (1) Earthmoving, Construction, and Materials Handling Machinery--track and wheel and tillage tractors, track and wheel loaders, lift trucks, self-guided vehicles, motor graders, wheel tractor-scrapers, track and wheel skidders, track and wheel excavators, backhoe loaders, log loaders, tree harvesters, off-highway trucks, paving machines, and related parts and equipment; and (2) Engines--for earthmoving and construction machines; on-highway trucks; marine, petroleum, agricultural, industrial, and other applications; electric power generation systems; and related parts. Caterpillar diesel and natural gas engines meet power needs ranging from 80 to 6,640 horsepower (60 to 4,950 kilowatts); and, in generator set configurations, from 36 to 5,250 kilowatts. Turbines range from 1,200 to 22,370 horsepower (895 to 16,680 kilowatts) and, in generator set configurations, from 800 to 16,360 kilowatts.

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[1] Section 232 of the Trade Expansion Act of 1962 (12 USC 1862(b)) provides in relevant part:

> If the Secretary [of Commerce] finds that such article is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security, he shall so advise the President and the President shall take such action, and for such time, as he deems necessary to adjust the imports of such article and its derivatives so that such imports will not threaten to impair the national security, unless the President determines that the article is not being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security.

Caterpillar products are manufactured in 15 plants in the U.S. and in 14 plants outside the U.S. Plants outside the U.S. are operated by wholly-owned subsidiaries in Australia, Belgium, Brazil, Canada, France, Mexico, and the United Kingdom; by an 80 percent-owned subsidiary in Indonesia; and by 50 percent-owned affiliated companies in Japan, India and Italy. Caterpillar products are also manufactured by contract manufacturers in the U.S., Canada, Norway, France, South Korea, the United Kingdom, and West Germany. In addition, products are produced under license by independent manufacturers in the U.S., Argentina, India, Malaysia, New Zealand, the People's Republic of China, South Africa, South Korea, and Turkey.

In 1986, Caterpillar had world-wide sales of $7.3 billion and employed over 50,000 people. Domestically, sales were $4 billion, and employment stood at 36,000 workers. In that year Caterpillar contributed a net of $1.1 billion to the U.S. merchandise trade balance as it maintained its position as one of the leading exporters in the U.S.

Caterpillar is a significant supplier of machinery to the military, including products such as track-type tractors (bulldozers), wheel loaders, motor graders and scrapers. This machinery is indispensible for rapid mobilization scenarios, as well as in forward combat areas for the construction of air bases, ports, roads and military encampments. In addition to machinery, Caterpillar provides a range of diesel engines to the military for power generation, marine propulsion and a variety of uses.

Over the past few years, Caterpillar has made sales of several hundred million dollars to the U.S. Department of Defense (DOD). Of course there are in addition many hundreds of millions of dollars in indirect military sales of merchandise utilized to meet DOD contracts by Caterpillar's private sector customers.

Caterpillar is committed to maintaining and improving its international competitiveness. In order to do so, the costs of purchased components used in manufacturing Caterpillar products must be brought under control, while the highest standards of quality are maintained. Caterpillar believes that the relief sought by petitioner under Section 232 would be extremely detrimental to the national security of the United States because the import protection requested would inevitably lead to a non-competitive, technologically backward and unresponsive bearing industry. Furthermore manufacturers of products utilizing bearings, such as Caterpillar, will themselves be unable to remain competitive from a U.S. manufacturing base and will be forced to relocate production off-shore to contain component costs. Therefore while Section 232 relief may result in some increase in U.S. bearing production, engine, vehicle and heavy equipment manufacturing will decline.

In fact Caterpillar in recent years has already been compelled by worldwide competitive forces to engage in a major restructuring of its manufacturing capacity, with the shift of some production to lower cost facilities abroad in an effort to bring manufacturing costs under control. Past U.S. government trade and fiscal policy actions have significantly contributed to these escalating costs, and therefore to this restructuring. Now, when the decline of the dollar is finally beginning to restore American competitiveness on world markets, would be the worst possible time to offset these gains by still another wrong-headed policy decision.

Perhaps most ironic, U.S. bearing products would continue to remain hostage to possible interdiction of trade even should the U.S. become totally self-sufficient in bearings since most bearing steel is imported. Therefore unless steps are contemplated to make the U.S. self-sufficient in bearing steel as well as bearings, any restrictions on bearings would be worse than an exercise in futility. If trade restrictions on bearings are imposed, increased bearing costs would tend to drive the heavy industry needed to produce weapons and support equipment such as tanks, trucks, airplane and ship engines, etc. abroad to escape from costly import restrictions, leaving the U.S. industrial base unable to respond to defense needs, even in peacetime.

Unless we are to revert to the use of sling shots with bearings as the missiles of choice, the relief sought by the Anti-Friction Bearing Manufacturers' Association can not enhance the national security of the United States. Should it be deemed necessary to assist domestic bearing producers to increase their efficiency and technology in order to maintain meaningful competition in the U.S. market place, the appropriate and most efficient way to achieve this objective would be through direct government financial assistance to the domestic producers under the various government programs already in place, including government funded research and development of materials and products.

I. Section 232 Is Not An Import Relief Statute.

It is clear that Congress did not intend that the National Security provision be used as an alternative to the various import relief remedies, such as Section 201, Section 301, the antidumping or countervailing duty laws or other trade law provisions. Section 232 is uniquely designed to deal only with those situations where there is a direct nexus between the imports in question and a threat to national security.[2] The most recent study of this industry by the International Trade Commission found that the domestic industry has maintained its capacity[3] and has "met import competition in domestic markets with relative success."[4] Despite these findings, the principal argument of the petitioner (which appears to have some support from the Joint Logistic Commanders Bearing Study of June, 1986[5]) is that because imports are concentrated in the profitable high volume, low-tech end of the market, the domestic industry will be increasingly unable to meet demand for (1) high value, precision and specialized defense bearings in peacetime, where in fact the domestic industry dominates the market, or (2) commercial-type bearings in time of war.

While it is true that imports have captured a significant part of the U.S. market, there appears to be little evidence of any actual threat to the national security as a result. Domestic producers continue to be competitive in the high-tech precision bearings used in weapons systems and other direct military production. Furthermore, as the Department of Commerce found in its 1983 investigation of the fastener industry[6] the foreign countries which are now the principal suppliers of imported bearings, namely Japan, West Germany, Canada, Singapore, Italy, the United Kingdom and a number of others, are friendly to the United States and would continue to be reliable sources of supply during mobilization and thereafter, with little potential for meaningful interdiction[7] especially with regard to Japan, Canada and other non-European suppliers. It is difficult to envision any realistic scenario which would result in serious interdiction of those imports.

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[2] For legislative history which clearly sets forth the limited circumstances under which the national security provision is to be used, see statements of House Ways and Means Committee Chairman Cooper during debate on adoption of the national security provision, 101 Cong. Rec. 8159-8161 (1955).

[3] Competitive Assessment of the US Ball and Roller Bearing Industry, USITC Pub. 1797, Jan. 1986, at 18. (hereinafter "ITC Study")

[4] Id., at 24.

[5] Joint Logistics Commanders Bearing Study, Joint Group for the Industrial Base, June 18, 1986, (hereinafter "DOD Study").

It would appear that petitioner is attempting to use Section 232 to obtain relief from a general increase in import penetration which petitioner believes to be adversely affecting the domestic industry. The appropriate vehicle for relief in such circumstances is the escape clause provision.[8] If "unfair trade practices" exist then the domestic industry has available a whole array of potential remedies, depending upon the circumstances.[9] In fact, as the Department is undoubtedly aware, this industry has a long history of seeking relief under various of these statutes, with some success. For instance the Timken Company has been successful in obtaining the issuance of antidumping orders concerning a number of overseas suppliers of tapered roller bearings.[10] It would be contrary to the intent of the law and the best interests of the United States to impose import restrictions under authority of Section 232 in circumstances where other trade remedy laws are appropriate. Such action could lead to a general disregard of the limitations placed on the use of the national security exception to the general prohibition on import restrictions in Article XXI of the General Agreement on Tariffs Trade (GATT). The United States has historically been extremely careful in using Section 232 (which is the domestic implementation of Article XXI) so as to avoid adverse effects on our foreign and trade policies and to prevent the creation of a major loophole in the GATT disciplines which support the multilateral trading system.[11] In fact only the petroleum industry has formally received protection under this provision. Clearly, the imposition of restrictions on bearings, given the weakness of petitioner's case here and the importance of international trade in bearings, would signal to our trading partners an abandonment by the U.S. of our long-standing policy of very narrowly construing Section 232 and Article XXI. We should thereafter anticipate a surge of actions by our trading partners to restrict importations of a broad range of products under the umbrella of GATT Article XXI. We do not believe such a course of events to be in the U.S. national interest, nor in the best interests of Caterpillar and the similarly situated U.S. corporations.

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[6] The Effect of Imports of Nuts, Bolts, and Large Screws on National Security, U.S. Dept. of Commerce, Feb. 1983. (hereinafter "Fastener Investigation").

[7] Id., at 53-54.

[8] Section 201-203 of the Trade Act of 1974, as amended, (19 USC 2251).

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[9] These include the following: The antidumping law (Title VII, Subtitle B of the Tariff Act of 1930, as amended (19 USC 1673)); The countervailing duty law (Section 303 and Title VII, Subtitle A of the Tariff Act of 1930, as amended (19 USC 1303, 19 USC 1671)); Section 301 (Title III, Chapter 1 of the Trade Act of 1974, as amended (19 USC 2411)); Section 337 (Tariff Act of 1930, as amended (19 USC 1337)).

[10] Japan (41 F.R. 34974, August 18, 1976 and 52 F.R. 37352, October 6, 1987); People's Republic of China (52 F.R. 22667, June 15, 1987); Hungary (52 F.R. 23319, June 19, 1987); Romania (52 F.R. 23320, June 19, 1987); Italy and Yugoslavia (52 F.R. 30417, August 14 1987).

II. The Relief Sought By Petitioner Would Diminish The Capacity of U.S. Industry to Provide For The National Security

The proposal contained in the petition[12] would not enhance the national security of the United States. On the contrary, the embargoes and quotas on bearing imports petitioner seeks[13] would significantly diminish the capacity of the U.S. economy as a whole, and U.S. heavy industry in particular, to respond to the peacetime and mobilization needs of the military establishment and its civilian support industries.

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[11] Fastener Investigation at 57.

[12] Petition Under Section 232 of the Trade Expansion Act of 1962 For Adjustment of Imports of Ball and Roller Bearings, Anti-Friction Bearing Manufacturers Association, July 17, 1987 (hereinafter "the petition").

[13] *Id.* at 64-70, and Appendix B.

A. There Is Insufficient Domestic Production Of Bearing Quality Steel to Support The Needs Of The U.S. In Peacetime, Or During Mobilization.

According to the petition, import penetration by volume in 1986 stood at 64.5 percent of the domestic market for ball bearings, and 40 percent for tapered roller bearings.[14] (Import penetration by value is much lower. In 1985 the ITC found that for the first six months of that year the import to consumption ratio, by value, was 18.5 percent for ball bearings, 18.7 percent for tapered roller bearings, and 17.1 percent for other roller bearings.[15])

While imports have been directly supplying a significant proportion of U.S. bearing consumption, imported steel is apparently used in almost all bearings consumed in the U.S. when bearing imports and bearing steel imports by U.S. bearing manufacturers are considered together. In its 1985 study of the impact of steel restraints on selected U.S. industries, the ITC, quoting industry sources, stated that 90 percent of bearing steel used by U.S. industry is imported.[16] Thus if 40 percent of U.S. roller bearings are imported, and 90 percent of the steel in domestically manufactured bearings is imported, then 94 percent of the total steel consumed in those bearings in the U.S. is produced abroad. (U.S. exports of bearing steel are almost non-existent so that any U.S. steel content in imported bearings can be disregarded.) For ball bearings the imported steel content is even higher, at 96.5 percent!

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[14] *Id.* at 17.

[15] ITC Study, at Table 25.

According to the ITC, again citing industry sources, U.S. bearing manufacturers buy foreign steel because the quality grade needed for bearings is not readily available from the U.S. steel industry at prices as low as imported steel. These sources stated that:

> even if U.S. steel manufacturers were willing to improve and modify techniques to produce the type of steel needed for bearings production at a competitive price, such production may not be able to supply the domestic demand for at least 5 years.[17] (Emphasis added)

Domestic bearing producers have been concerned that import restraints on bearing steel will create a shortage, since demand may exceed domestic bearing steel producers' ability to supply bearing manufacturers.[18] A further reduction in the availability of imported steel now being supplied indirectly as finished bearings or parts, as would result from the relief sought by petitioner, would greatly exacerbate this situation.[19]

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[16] The Effects of Restraining U.S. Steel Imports On The Exports Of Selected Steel-Consuming Industries, Inv. No. 332-214, USITC Pub. 1788, December 1985, at 50 (hereinafter "ITC Steel Study").

[17] Id., at 50-51.

[18] Id., at 54.

Petitioner fails to address the issue of raw material supply even when discussing the competitive disadvantage the domestic industry faces vis-a-vis its foreign competition. It seems somewhat disingenuous, at best, for petitioner to fail to mention that the raw material which constitutes 40 percent of the finished cost of the bearings produced domestically must be imported from its foreign competitors, in its description of the present state of the industry, and in analyzing its inability to compete with foreign producers.

The DOD Study acknowledges the existence of steel import restraints and their impact on domestic bearing producers.[20] The study cites domestic bearing producer reports that their material costs are 20 percent higher than Japanese material costs, and that there are no domestic sources for vacuum degassed AISI 52100 steel, which is used in the manufacture of bearing rings and balls.[21] However, like the petition, the DOD Study totally ignores U.S. dependence on overseas suppliers for its bearing steel in considering the national security implications of market penetration of foreign bearings. None of the recommendations or discussions in the DOD Study address this steel dependence, much less face the issue of how to make the U.S. military establishment and private sector less dependent upon imports--which allegedly are an insecure source of supply during mobilization and war scenarios--by imposing import restrictions on bearings but ignoring the lack of domestic capacity to produce bearing steel.

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[19] Imported speciality steel, including bearing steel, has been subject to restraints of one kind or another since the mid-1970's, but the domestic industry has apparently been unable despite this protection to become internationally competitive.

[20] DOD Study, at 8.

[21] *Id.*, at 39.

If imports of bearings can be cut off during periods of international turbulance, certainly steel imports are equally, if not more, vulnerable. In fact, bearings which are merely steel at a more advanced stage of processing are easier to transport than the steel bars, rods or wire from which they are made. It is quite possible to contemplate the movement of large quantities of bearings by air transport during times of interdiction of ocean shipping, at reasonable cost and without putting undue strain on the transportation system. In fact it is our understanding that certain high value bearings currently are routinely transported by air. Obviously air transport of quantities of steel is another matter entirely.

Clearly, if the United States cannot safely rely upon foreign sources of supply for defense bearing requirements, as the petitioner and the DOD study maintain, we cannot rely on the same sources for bearing steel. Assuming this premise to be correct, it would be the height of folly to attempt to redress the U.S. dependence on foreign bearings without first addressing the much greater dependence on foreign bearing steel.

Present and past efforts to assist the domestic speciality steel industry, through import restraints stretching back over ten years, have accomplished little other than to increase the profitability of the domestic speciality steel producers.[22] If that industry is to expand its capacity and increase its efficiency so as to be able to produce all of the high quality bearing steel necessary to meet the national security needs of the U.S. it appears that direct, and expensive, government intervention will apparently be required. However, such action must precede any general restrictions on bearings, since there has been no showing that sufficient foreign sources of bearing steel will be available to domestic bearing producers to replace the steel now entering the U.S. in the form of bearings and parts. It would be surprising if foreign mills, which also tend to produce bearings, were cooperative when asked to expand their steel exports so that U.S. producers can absorb their current share of U.S. bearing markets. This is a matter which must be considered prior to restricting bearing imports. Similarly there has been no investigation of how much bearing steel can be produced domestically, and after how much lag time--although some bearing producers believe it would take 5 years for the domestic industry to replace present direct imports of bearing steel.23/

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[22] Relief under the escape clause (Section 201 of the Trade Act of 1974) was provided from 1976-1980 in the form of an Orderly Marketing Agreement (OMA) with Japan and quotas on other suppliers. Products covered were certain stainless and alloy tool steel bars, wire rods, plates, sheets and strips. The relief on bearing steel was terminated by the President in 1977 after advice from the ITC that terminating this releif would have negligible effect on the domestic industry. From 1982 to the present these products have been again subject to a series of OMA's/VRA's, quotas, and tariff increases as the result of relief granted pursuant to an investigation under Section 201, and the President's steel restraint program. Bearing steel has again been excluded, along with certain other specialty steel products, presumably because there is insufficient domestic production to meet demand. In this regard, see Presidential Proclamation 4509, June 15 1977, terminating quotas on bearing steel.

The immediate effect of restrictions on bearings as requested by the petition would be a severe disruption in domestic bearing supplies, with unpredictable consequences for the U.S. industries producing products using bearings. Prices would sky-rocket, and for an indeterminate period the ability of the U.S. to manufacture a broad range of products, many of which are for military use, would be endangered. The longer term results of such action are discussed in Section II B of these comments, below.

Insofar as security from trade interdiction is concerned, obviously nothing would be accomplished.

This discussion would not be complete without again citing the previous rejection by the Department of Commerce of the petition's underlying assumption--that foreign sources of critical products,

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23/ ITC Steel Study, at 50-51.

such as bearings or steel, are unreliable per se. As noted above, DOC concluded that foreign countries would continue to be major sources of fasteners during mobilization or emergency situations. The Department further stated:

> It is assumed that most of the industrialized countries which are friendly to the U.S. and which have skilled, dependable work forces will remain friendly and will support, through increased production efforts, our emergency needs.
>
> * * * * * * *
>
> An increase in fastener imports would not be unrealistic, particularly from Japan and Taiwan, which have large exporting capabilities. These countries are politically stable, have skilled work forces, and are friendly to the U.S.[24]

What was true for fasteners in 1983 is true for bearings today. It would appear that under any remotely realistic set of mobilization and emergency circumstances significant foreign supplies of bearings and bearing steel would continue to be available to American industry. If the Department decides that, contrary to its determination in fasteners, foreign supplies of bearings cannot be depended upon, then it must devise a plan of action to first address the deficiency in availability of domestically produced bearing steel. Furthermore it must also assess the likely impact of any such restrictions, whether on bearings, steel, or both, on American industries utilizing bearings.

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[24] Fastener Study, at 53-54.

B. Imposing Import Restrictions on Bearings Would Adversely Affect U.S. Industry and Promote Foreign Production of Machinery Using Bearings

In addition to its failure to address the dependence of the U.S. bearing industry on imported bearing steel, the petition is flawed for an equally compelling reason--bearings are not weapons. By themselves they are of no use for national security or any other purpose. It is the machinery in which they are incorporated--tanks, trucks, construction equipment, machine tools, weapons systems, etc. --that are vital to the national defense. Therefore action which may increase the self-sufficiency of the U.S. in bearings, but which decreases the capacity of U.S. industry to produce that machinery will have a net adverse effect on the overall ability of the economy to respond to peacetime as well as mobilization national security needs. In carrying out the specific authority contained in Section 232, as well as their responsibilities for maintaining the health of U.S. industry as the principal bulwark against aggression, the President and the Secretary must not fail to consider whether proposed import restrictions will result in an overall lessening of U.S. defense capabilities, regardless of the possible salutory effect on a particular segment of the economy.

Those American industries which produce engines, trucks, motor vehicles, construction equipment, machine tools and other heavy equipment have been struggling in recent years to compete in terms of price and quality with foreign products. Caterpillar designs, manufactures and markets earthmoving, construction and materials handling equipment as well as a variety of engines, as detailed above. Caterpillar products are manufactured in the United States and in more than 20 foreign countries.

Because of greatly increased foreign competition for these products Caterpillar embarked on a massive cost reduction program in 1982. Caterpillar entered this decade with worldwide employment of 89,400; by the end of 1986 the total had been reduced to 53,700, of which 36,000 were employed domestically, down from 60,000. Manufacturing space during this period has been cut from 45 million square feet to approximately 34 million, and further plant closings may result in an additional reduction of 3.8 million square feet.

In 1982 Caterpillar suffered its first loss in 50 years, and while those losses turned to small profits in 1985 and 1986, for the last 2 quarters of 1986 and the first quarter of 1987 the company suffered aggregate losses of over $250 million. During this period the foreign share of the products Caterpillar manufactures has increased dramatically. This competitive environment has compelled Caterpillar to engage in a major restructuring of its production facilities, as noted above, with the shift of some production to lower cost facilities abroad in an effort to bring manufacturing costs under control. An ambitious program to reduce costs by 22% by 1986 was begun in 1982. The target was later advanced to 1985, and this goal was nearly achieved. For the five years 1986-1990 Caterpillar is committed to a 15-20% additional reduction against the 1985 base. A 3% cut was accomplished in 1986, and 1987 budgets of all operating units were cut 5% more.

These reductions have been accomplished in an environment of strong price competition, mostly driven by foreign producers. As an illustration of what is occurring in the global market place for these products, in 1986 the average transaction prices for Caterpillar products were still at 1981 levels. Only the vigorous cost reduction program embarked upon in 1982 enabled Caterpillar to continue to compete aggressively, both at home and abroad. As a result, the company has been able to maintain and increase its sales both domestically and overseas even while engaged in this massive restructuring program.

Caterpillar's total sales in 1986 were $7.3 billion, up from $6.7 billion the previous year. U.S. sales were up to $4 billion from $3.8 billion; European sales went to $1.1 billion from $800 million; Canadian sales to $485 million from $425 million; Latin American to $543 million from $467 million. Sales in Africa/Middle East and Asia/Pacific declined, showing the effects of very strong Japanese competition in those regions.

Caterpillar is committed to maintaining and improving its international competitiveness--a competitiveness which permitted the company to support 14,500 U.S. workers with export sales in 1986 and to contribute a net of $1.1 billion to the U.S. merchandise trade balance. Clearly that competitiveness is critical to Caterpillar's ability to offer a full line of earthmoving, construction, and materials handling machinery and engines to support U.S. national security. Only a company which participates significantly in foreign as well as domestic markets can afford to maintain full product lines and facilities for the design and manufacture of the wide variety of these products required for an industrialized economy and its military establishment.

Caterpillar's ability to maintain its competitive position has been endangered in the past by the escalating costs of purchased components, including bearings. These component costs must be brought under control while the highest standards of quality are maintained. It has been Caterpillar's experience that foreign competition is necessary to spur domestic component producers to control their prices and to adopt state-of-the-art quality control processes. Especially where the domestic component industry is dominated by a single supplier, as is the case for tapered roller bearings where the Timken Company has a near monopoly position, the danger of stagnation, inefficiency, high prices and less than optimum quality is high.

As Caterpillar's representative at the ITC hearing on TRBs from Japan stated:

> If we are to maintain our ability to manufacture in the United States and export to world markets in competition with Japanese and other foreign manufacturers, we cannot pay more for components and raw materials than they do.
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> In our view it is this need for international competitiveness which has forced the industries which use TRBs, such as Caterpillar, to look to overseas suppliers to help moderate the cost of their U.S. production. TRBs are used in the manufacture of just about everything Caterpillar makes. In 1986 we purchased between $25 and $30 million worth of tapers from all sources.
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> * * * * * * * *
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> It was because of our belief that a full line producer of tapered roller bearings as an alternative to Timken was necessary as part of our cost reduction program that Caterpillar sought out NTN Toyo and signed a contract with that company in 1983.[25]

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[25] U.S. ITC Inv. Nos. 731-TA-341-346, Tapered Roller Bearings and Parts Thereof from Hungary, Italy, Japan, the PRC, Romania and Yugoslavia; Hearing of May 12, 1987, at 130-132. Also see Caterpillar submissions to the Internatioal Trade Commission in this investigation as well as that concerning crankshafts from a number of countries. These submissions are attached as Appendix I to these comments.

It is imperative that the Department clearly understand that companies like Caterpillar cannot and will not become dependent upon single, inefficient domestic sources for critical components. Caterpillar's success in maintaining a U.S. manufacturing base for diesel engines, for example, is contingent upon continued access to components which are available at competitive costs, whether imported or domestically produced. Caterpillar manufactures diesel engines in four countries: the United States, Belgium, Brazil, and, in a joint venture, Japan. Decisions on where to manufacture engines for world markets, keeping in mind that about 21% of all Caterpillar products manufactured in the U.S. are exported, are based on cost comparisons for these facilities. Even a modest cost increase for one facility, i.e. the United States, may be sufficient to cause a shift of production to another site, especially for engines already being produced in more than one country.

Caterpillar is obviously not unique among heavy equipment, vehicle, and engine manufacturers. All are caught in a squeeze between domestic costs and low-priced foreign competition. Engine manufacturers who participated in the International Trade Commission investigation of forged steel crankshafts (another critical engine component) from a number of countries had in common the fact that they all were embarked upon intensive and dramatic cost-reduction programs from the early 1980's onward, in order to retain their competitiveness in a stagnant market, increasingly penetrated by low-cost foreign engines and finished products.[26]

Thus, at the hearing in that investigation,[27] a representative of the Cummins Engine Company made the following statement about the effect of foreign competition on the price and quality of crankshafts:

> Until the mid to late seventies, Wyman-Gordon really had little serious competition from any other crank forging manufacturer, domestic or foreign. As a result, Wyman in effect enjoys a monopoly position in the U.S. market and was able to charge Cummins and in fact all its other customers very high prices.
>
> As one might expect, the high prices being commanded by Wyman eventually attracted some new entrants into the U.S. market. Foreign manufacturers of crankshafts such as Thyssen and Sumitomo began very earnestly competing with Wyman in the late seventies.
>
> These non-U.S. manufacturers employed state of the art technology and very efficient manufacturing processes and material flows in the production of forged steel crankshafts. And of course, the resultant cost and quality advantages enabled them to produce a superior product at a lower cost than Wyman-Gordon.

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[26] While clearly recent exchange rate trends have been useful in enhancing U.S. competitiveness, for whatever reasons these currency changes are not fully reflected in prices of internationally traded products. Futhermore, U.S. bearing producers presumably have also benefitted and are thus in a stronger competitive position.

[27] Transcript of ITC Investigations No. 701-TA-282 (Final), 731-TA-351 and 353 (Final), Certain Forged Steel Crankshafts From Brazil, The Federal Republic of Germany, and The United Kingdom; Hearing of August 4, 1987.

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> 1982 from an historical basis was a watershed year for both Cummins and its suppliers. Cummins became faced with a very serious challenge from foreign competition, particularly from Japanese diesel engine manufacturers and European truck producers, who also happened to produce their own engines.[28]

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> We found our diesel engine prices repeatedly undercut by very sizeable margins. And to make matters worse, the overall demand for heavy duty engines was falling.

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> Cummins responded immediately and I think very decisively to counteract the inroads the foreign diesel manufacturers were threatening to make with the high quality, low cost engines, as all builders in this country had to do.
>
> In order to compete with foreign diesel engine manufacturers in a shrinking market, we embarked on a very ambitious plan to improve quality and customer service and cut costs drastically across the board. Obviously, we could no longer accept price increases from suppliers. On the contrary, we had to demand significant price reductions on all the components of the engine.[29]

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> Cummins, for instance, remains committed to sourcing from world technological leaders and we dual source as a matter of policy. We should not let Wyman-Gordon lose the beneficial, technical and what I call broad business incentives that come from unrestricted

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[28] Id. At 240-241.

[29] Id. At 242.

> competition, the same competition which in my opinion has caused the significant improvements of the past ten years in this industry.[30]
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> * * * * * * * *
>
> Cummins neither receives nor seeks protection of any kind on competing in this world diesel engine market. We must, however, have the ability that our international engine competitors enjoy to purchase high quality components from the lowest cost suppliers. We are confident that we can succeed in the marketplace that we see, unless the actions of the nature requested by the Petitioner here place us and the entire U.S. engine business, Cummins and the engine business, at a disadvantage to our international competitors.[31]

The spokesman for Deere & Company, another domestic manufacturer of diesel engines, as well as agricultural equipment expressed similar sentiments:

> Due to increased competition, especially from foreign markets, Deere & Company embarked on an aggressive cost reduction and quality improvement program in all of our factories to provide better value to our customers. Cost reduction objectives of 25 to 30 percent in five years were common.
>
> As part of this effort, Deere & Company was forced to identify the best world class suppliers of many kinds of components, including crankshafts, seeking the most efficient, long-term suppliers in order for Deere to remain competitive. We could no longer rely

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[30] Id. At 244.

[31] Id. At 245.

> solely upon local supply markets if they were noncompetitive.[32]
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> Deere has obtained superior forgings from its foreign suppliers. Advances in closer tolerances, improved steel, consultation on oil film thicknesses and potential cost reductions as a result of normalized-only forgings, among others, were made available from our other suppliers. These technological advances offered significant advantage to us in terms of lessening of manufacturing time and cost in addition to superior crankshaft and engine performance. These, of course, are essential in offering a comeptitive product.[33]

At the Staff Conference at the preliminary stage of this investigation a representative of Navistar International Corporation (formerly International Harvester Co.), a major U.S. manufacturer of medium and heavy duty trucks, as well as diesel engines for use in light duty vehicles, voiced much the same concern.[34] The Navistar spokesman stated:

> The market for medium duty and heavy duty trucks in the United States has been depressed since the beginning of

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[32] *Id*. At 269-270.

[33] *Id*. At 274.

[34] Transcript of ITC Staff Conference; Investigations Nos. 701-TA-282 (Preliminary) and 731-TA-350 thru 353 (Preliminary), *Certain Forged Steel Crankshafts From Brazil, The Federal Republic of Germany, Japan and The United Kingdom*; October 31, 1986.

the 1980s. Foreign competition, foreign producers have become a major factor in the market. Daimler-Benz from Germany, Volvo, and Renault are factors. Those are the three largest truck producers in the world. Several Japanese companies are affecting our market, as well as vehicles produced from other countries such as Brazil or produced in part in Brazil.

The market for medium, for light duty diesel engines is also very much affected by foreign competition, pickup trucks and that type of vehicle. The problems for domestic producers of those vehicles is well known, again, importation from Japan, are major factors. In 1983, Navistar undertook a major review of its source of supplies.

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The objective of the review was to locate suppliers who could supply a higher quality product at an improved cost. We felt that this was necessary for us to be able to compete in our marketplace. During some very rough years for our company we maintained our share of the United States market for medium and heavy duty trucks that we attributed substantially to our commitment to continually improve our product and its technology.[35]

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We feel that our ability to obtain crankshafts from any source in the world is very important to our competitive position. If we can't obtain the highest quality crankshafts

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[35] *Id*. At 181-182.

> at a favorable price, that puts us at an unfair competitive advantage with other truck producers and other engine producers in our marketplace.
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> We think that foreign produced crankshafts will be in trucks in the United States. The question for us is whether those trucks will be produced by United States companies such as Navistar or whether those trucks will be imported from foreign countries.[36]

Clearly the sentiments expressed by these American manufacturers of engines, farm equipment and trucks concerning crankshafts applies equally to bearings and to other critical components of their products. They cannot compete if they are deprived of unrestricted access to the most efficient suppliers, worldwide, of those components. To this list of hard-pressed U.S. industries we can certainly add, without fear of error, the machine-tool and automobile industries whose deteriorated competitive positions are well known to the Department and to the U.S. government in general.

The companies of these industries are critical to the American economy. It would be disasterous, far beyond any immediate or even long term effect on the defense establishment, for there to be further shrinkage of that portion of the U.S. manufacturing base represented by the companies of these industries. Yet that is precisely what can be anticipated from the embargoes and severe cutbacks in foreign bearing availability requested by petitioner.

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[36] Id. At 185.

As these companies either contract or relocate their operations offshore, where components and raw materials (such as steel) are available at world-prices, will the U.S. national security be less threatened because of increased availability of domestically produced bearings?

Caterpillar is not in a position to fully assess the contribution of bearing consuming industries, dependent upon commercial sales for the bulk of their revenues, on national security. We do however have some expertise with regard to the products manufactured by Caterpillar.

In time of mobilization, construction equipment is used in construction, transportation, logging, material handling, agriculture, mining, and energy development. Many of these uses are the key to rapid mobilization. In a war situation, construction machinery is in great demand. It makes possible the rapid expansion of plants for producing war material, the expansion and construction of air bases, ports, camps, and other military facilities. It is utilized to produce raw materials, and expand the industrial base. In combat, construction equipment is used in the building of roads, air fields, and other facilities right up to the front lines. The U.S. military services utilize four basic types of Caterpillar construction machinery: the D7 Track-type Tractor, the 936 Wheel

Loader, the 621 Standard Wheel Tractor Scraper, and the 130 Motor Grader. These four provide the backbone for military construction and engineering. In addition, the Navy uses D8 Track-type Tractors and selected parts of the Army and Marine Corps use D5 Track-type Tractors. These construction machines are standard issue to combat and combat support forces in both active and reserve component units. In addition to these basic construction machines, the military forces use a variety of other machines, including 980 Wheel Loaders, D6 Track-type Tractors, paving equipment, etc. The Army and Marine Corps also use modified 988 Wheel Loaders with a lift mast as a rough terrain container handler -- to handle a variety of sizes of containers in poor underfoot conditions. Catepillar represents a very significant proportion of military construction equipment procurements according to our estimates.

In the Vietnam era the industry provided large quantities of similar construction machines. In addition, a number of specialized machines, including D9 Track-type Tractors and other large commercial machines, were used for major port and highway construction.

In addition to construction equipment, Caterpillar provides engine power for a significant number of stationary and mobile applications for the Department of Defense. These engines are used for power generation, marine propulsion, and for power for other types of machinery, including cranes, asphalt plants, etc.

Caterpillar products are used by many contractors, suppliers and OEM manufacturers for military contract purposes.

Caterpillar direct sales to the Department of Defense in recent years is provided in Confidential Appendix II, attached hereto.

In past years U.S. producers, including Caterpillar, dominated world markets. That is no longer true. According to data supplied by the Construction Industry Manufacturing Association, and the Department of Commerce, in 1976 approximately 10% of commercial construction equipment units sold in the U.S. were imported, while in 1986 import penetration reached 48%. If the assumption that foreign suppliers of products needed for national security purposes are unreliable is correct, then restricting bearing imports, and thereby speeding up the relocation of the construction equipment and similarly situated industries to foreign locations will adversely affect national security. It is a simple matter of common sense. It is a lot simpler to import ball bearings than D9 tractors!

CONCLUSION

Ball and roller bearings are industrial inputs. They appear in the middle of the production process between raw material and finished product. Attempting to assess the national security impact of ball and roller bearing imports in isolation is an exercise in futility. As we have tried to demonstrate, the steel from which bearings must be made is not readily available in the U.S., but that fact has been ignored by petitioner. The industries producing those finished products which are the bone and muscle of the U.S. economy and military establishment have been compelled to drastically reduce costs to remain competitive, and thereby remain available for the defense of the United States. The inevitable increases in costs and decrease in quality of bearings which will result from import protection, and the consequences of those phenomena on national security through decreased domestic production of machinery, vehicles, engines, etc., has also been ignored by petitioner.

The Secretary and the President must consider the total likely effect of import restrictions requested under Section 232. Such consideration can only lead to rejection of embargoes, quotas, VRA's, or other import restrictions on bearings. Policies which protected certain U.S. industries at the expense of others (e.g. the steel VRA's) have handicapped American exporters in world market-places. Past policy errors must not be compounded by granting unwarranted protection to U.S. bearing producers. The U.S. must remain globally competitive as the best way of assuring military preparedness.

A report to Caterpillar shareholders by the company Chairman George A. Schaefer and President Peter P. Donis in the 1986 Annual Report entitled Competitiveness in a Global Economy succinctly stated the case:

> In January 1985, the President's Commission on Industrial Competitiveness produced an incisive, comprehensive set of recommendations which have since been largely ignored by Washington policymakers.
>
> We hope that such won't be the case in the coming 1987 Congressional debate over a landmark trade bill. The focus of that debate ought to be advancement of U.S. competitiveness in a growing world economy. America shouldn't resort to protectionism. Rather it should work to fashion a world trading system that supports freer trade, and encourages other nations to forsake the protectionism which they now often practice against American goods and services.

The relief sought by petitioner would be nothing more than pure protectionism. It would not advance the national security of the U.S. but would, on the contrary, adversely effect the capacity of U.S. industry as a whole to respond to civilian and military needs, both in peacetime and in times of emergency and mobilization. If the domestic industry is to be assisted to become more competitive in terms of price and quality that assistance should be in the form of direct aid, under existing government programs, to upgrade efficiency, help fund modernization and encourage development of new technology. Import restrictions have historically had the reverse effect on the protected industry and merely inflated the profits of the companies benefitting from the protection.

Senator WEICKER. Nancy Johnson from the Sixth District of Connecticut, who has long attended to the problems of the bearing industry and been articulate and eloquent in her presentation is with us this morning. In addition, she is a dear, close personal friend, and I am delighted to have you here with us, Nancy.

STATEMENT OF HON. NANCY L. JOHNSON, A U.S. REPRESENTATIVE FROM THE STATE OF CONNECTICUT

Representative JOHNSON. Thank you very much, Senator. I appreciate your holding this hearing. I think it is extraordinarily important that the Senate and the House and the executive branch be able to more clearly identify the problems that our industrial base faces and mobilize policies that address those problems.

Over the August recess I read Clyde Prestowitz's book called "Trading Places," and I recommend it to you because it reminds us that as early as 1981 we were able to identify the defense industrial base problems we now face. We saw that if we could enforce reciprocal market access principles and enforce our own dumping laws that we would be able to defend our own interests.

Well, we proposed those actions both on this side and in the executive branch. But as a Nation were unable to follow through on those matters, because we were simply unable to identify our own national interests and mobilize policies to defend and support them.

When I first was elected to Congress in 1982—and I just tell this story very briefly, because it reminds us of how eclectic the process used to be of addressing fundamental issues like the state of the bearing industry—I had companies come to me and remind me that all of the "quiet bearings" for America's submarines were made abroad, every one of them, total dependence. When I talked with the Department of Defense about this and got companies and Government to work together, we were able to change that and indeed, most of that production is now stateside-based.

We can do the job that has to be done, but we can only do it through hearings like this, through coordinated action and very decisive and determined efforts to identify our national interests and concerns and to adopt policies that promote those interests and concerns.

As you are well aware and you have mentioned in your opening statements, from the 1970's forward other governments have assisted their businesses with targeting our bearing industry. First the target was the high-volume low-value sector in which American manufacturers were most vulnerable, and now the target is the customized, specialized bearings which constitute our most strategic bearing interest. Foreign penetration of the U.S. market has grown so dramatically that it has now reached over 50 percent of medium-sized commodity bearings and you will hear from others today of the extraordinary penetration in high precision bearings and other aspects of the market.

By eroding our ability to produce high-volume low-value bearings, we lost the production base and the profitability that was so essential to the strength and vitality of our industry. I am very pleased that as we began to focus on this matter, DOD in 1986 undertook the Joint Logistics Commanders' Study, which confirmed the industry's perilous position and stated without equivocation that the industry was at the point of being ready to collapse and was in "imminent danger of being unable to support national defense needs."

Perhaps the most significant conclusion of the Joint Commanders' study was that decisive and immediate actions by the Federal Government were warranted if a domestic production capability was to be maintained. And out of that report did emerge the bearing action plan with its three goals: First, to better coordinate DOD bearing needs for the industry and assist the industry with cost considerations.

Second, to actually commit DOD money toward modernizing critical bearing production capacity; and finally, to put in place a time-limited rule mandating the procurement of American-made bearings by all defense contractors. My own Congressional district is one of the biggest bearing producers in the Nation with seven plants. I have seen the power of our industrial modernization incentives program to turn around bearing production to make it cost effective. Through modest expenditure the Federal Government will enable local bearing companies in my district to improve productivity with a payback over only two or three years. So, there are Government policies that can make a tremendous difference, and that is the kind of policy that will be strengthened by this hearing.

But the most significant Government action taken as a result of the study was the determination to adopt a buy-American rule under which DOD will buy U.S. made bearings for military applications during the next 3 to 5 years. And I am pleased to say that through the intense involvement of a variety of Members as well as strong executive department leadership, we do have very tight buy-American regulations. Managers of one important bearing company, New Departure Hyatt, was in my office only yesterday and mentioned the increased activity by American defense contractors at looking now for domestic sources of defense bearings. I am pleased that they are beginning to have effect. I know that over the long course they will have a very significant effect.

One of the effects that they will have is to provide the information domestic companies need to plan to gear up to produce economically and effectively quantities the Government is going to need.

But certainly buy-American regulations are not enough. There are other policy options that must be considered, that must be acted on if we are to have the bearing industry that America needs. It was the erosion of the commercial bearing sector in America that caused us to slide into a position where even our defense capability was in jeopardy. So, it is not enough simply to have buy-American regulations in the Defense Department. It is absolutely critical that we address the other problems that are before us.

And so I believe that the 232 petition must be acted on promptly and strongly. It raises purely and simply and single-mindedly the national security issue, and we have enormous volumes of information that indicate that indeed America cannot meet her own national security requirements with the bearing industry in its current state.

Also, the dumping petitions that are before the Department of Commerce are of enormous importance. Dumping was one of the key causes of our problems and expect the Department of Commerce is on its way to finding startling dumping margins. I know from my companies in Connecticut what has happened to prices in the face of the dramatic change in the value of the dollar versus the yen, and I know that prices have not reflected those currency changes. Accordingly, I expect those dumping margins will be startling and will precipitate the kind of action needed to defend not only the bearing industry, but some other basic industries in America, as well.

Not only must we see strong action on the dumping and 232 petitions, but we must also begin to build a stronger partnership between Government and industry, and between management and labor in America if we are going to succeed in the international marketplace. That is the fundamental issue behind both these hearings and the policies I have worked for and that I see us moving toward. Because if we do not rebuild that partnership between business and Government, if we do not overcome that belief that there has to be some arm's length relationship between the private and public sectors, then it is all right to have policies that positively conflict. It was all right in 1982 when DOD sent bearing companies letters saying they were worried about surge capacity while they were working with an American defense producer to qualify Japanese bearings for duty-free status. That it somehow was all right to pursue diametrically opposed policies. It is not all right. We know it is not all right, but we will never be able to assure it never happens again and replace that kind of chaotic policy with a unified policy unless we address our national interest. It is only through hearings like this that we can rebuild that focus and that partnership that is essential to defending our own national interest and assuring that we have the critical industries in place to support our national defense.

The stakes are very high both for national security and for jobs in my district and jobs in the state of Connecticut, and I commend you on holding these hearings, and I look forward to working with you in the next few months, and indeed over the coming years to assure the policies that we adopt now are ones that will serve our national security interest, our individual job issues in America. And I thank you for this opportunity to testify before you.

[The prepared statement of Congresswoman Johnson follows:]

STATEMENT OF

REP. NANCY L. JOHNSON

before the

Senate Committee on Small Business

September 8, 1988

MR. CHAIRMAN, thank you for the opportunity to appear before your committee today. With my distinguished colleague John Spratt of South Carolina, I have the honor of serving as co-chair of the Congressional Bearing Caucus. Despite the ball and roller bearing industry's difficulties of the past two decades, the industry remains an important cog in my state's economy with 16 bearing plants in Connecticut, including seven in my Congressional district.

During my first term in Congress in 1983, workers in my district brought it to my attention that the Department of Defense was looking to Japan for a new qualified supplier for high-precision "quiet bearings" used in submarines. While I was alarmed to learn that DoD was looking offshore for a component with such serious national security implications, I was also surprised by the response of DoD officials when I raised the matter with them. They assured me that they were indeed aware that buying such an important item from a foreign firm could threaten our capacity to produce it in the U.S., but that certain foreign sources had proven to be cheaper and more reliable than traditional U.S. sources. There was no consistency in official policy regarding bearings, and it was clear the ability of the U.S. bearing industry to meet national security needs was being exacerbated by our government's lack of recogition that the problem existed.

THE GROWTH OF FOREIGN COMPETITION

Like many heavy manufacturing industries, the bearing industry began to find itself in the 1970s facing strong competition from abroad. Often aided by government subsidies and supportive official export policies, foreign firms looked beyond their own markets to the U.S., initially targeting the high-volume, low-value sector in which American manufacturers are most vulnerable. The strategy has been successful: Today, only five companies -- three Japanese and two German -- produce nearly two-thirds of all bearings in the free world. Meanwhile, foreign penetration of the U.S. market has grown dramatically, reaching 61 percent in medium-sized commodity ball bearings in 1987.

From this success in the "low end" of the bearing market, foreign bearing makers have increasingly moved into higher-precision product lines until, inevitably, they now challenge U.S. firms for the customer that buys more precision bearings than any other in the world -- the U.S. Department of Defense. As domestic bearing makers were losing a growing portion of the American commercial bearing market to foreign competition, they were also losing the production base and profitabilty needed to provide DoD with the more sophisticated bearings it required. This was the "Catch-22" situation in which the domestic industry found itself in 1985 when I requested that

DoD conduct a comprehensive study of the industry's ability to meet national security needs.

DEFENSE DEPARTMENT ACTION

The sobering report, released in June, 1986 as the *Joint Logistics Commanders Study*, confirmed the domestic industry's perilous position. The study stated that the commodity sector of the industry had deteriorated to the point of being "ready to collapse" and was in "imminent danger of being unable to support national defense needs." Perhaps the most significant conclusion of the Joint Commanders' study was that "decisive and immediate actions" by the federal government were warranted if a domestic production capability was to be maintained.

From the conclusions of the joint commanders' report, DoD developed a "Bearing Action Plan" with three broad goals: first, to better coordinate DoD bearing needs with the industry and assist the industry with cost considerations; second, to actually commit DoD money toward modernizing critical bearing production capacity; and finally, to put in place a time-limited rule mandating the procurement of American-made bearings.

Through greater use of programs such as its Industrialization Modernization Incentives Program, or IMIP, DoD hopes to keep U.S. bearing companies focused on developing new, better technology. One manufacturer in my Congressional District recently completed a successful IMIP contract under which DoD's modest $1.6 million investment will pay for itself in productivity gains within two to three years.

But the most direct and significant government action ever taken on bearings is the new "buy-American" rule under which DoD will buy only U.S.-made bearings for military applications during the next three to five years. The buy-American policy is already creating new business opportunities for American bearing makers: Only yesterday, I met with bearing plant managers in my office who told me that such opportunities are beginning to appear for their company only one month after the buy-American rule was published.

IMPORT RELIEF STILL WARRANTED

But DoD does not buy enough bearings by itself to ensure a viable bearing capacity, so the federal government must pursue other policy options if the industry is to survive. While bearing makers are optimistic about the possibility of new or renewed business with DoD, they are also convinced that the buy-American rule alone will not be enough to fully strengthen the industry's ability to meet national security needs. We should not forget that U.S. bearing makers began to lose their ability to produce bearings for military applications when their share of the commodity bearing market began to erode.

Section 232 of the trade law gives the President explicit authority to limit imports or impose other measures when a critical industry is threatened, and I strongly feel that such action is warranted in the case of bearings. That power has helped resolve previous import problems similar to those faced by the bearing industry: In particular, the federal government was successful in negotiating voluntary restraint agreements with our trading partners on machine tool imports when tough unilateral action was threatened. The machine tool VRAs have since proven successful as machine tool orders continue to increase and some U.S. machine tool builders are actually exploring the export market. Clearly, a DoD buy-American policy on machine tools would not have been enough to strengthen market opportunities for U.S. machine tool builders, just as the bearing buy-American policy cannot be counted on to save that industry's strategic capability.

The Administration has delayed final action on the 232 petition until later this year to get a better picture of how other actions, such as the buy-American policy, will affect the industry. Also, as we will hear later today, the Department of Commerce is currently investigating dumping charges against nine countries and is scheduled to release preliminary dumping margins late next month. But neither of these actions can have any effect on a decision to act strongly in support of the industry's 232 petition. The buy-American policy will not have been in effect for long enough, and the dumping cases are outside the scope of available remedies in the 232 petition.

The federal government has repeatedly defined the dangers of allowing the domestic bearing industry to decline further, and has begun to take strong steps to stem that decline. Government must continue to strengthen its partnership with the industry and take further steps, such as temporarily limiting imports either through direct or negotiated action, to provide the industry with the time to become competitive. Action on the 232 petition would clearly show our trading partners that the U.S. is serious about ensuring a viable bearing production base. Meanwhile, the industry must continue working to assure high quality at competitive prices.

The stakes are high, in terms of both jobs and national security, and both government and the bearing manufacturers have much to lose by not acting swiftly and aggressively to rebuild this critical industry. Now I would be happy to answer any questions members of the committee might have.

Senator WEICKER. Nancy, thank you very much. It is about as concisely stated as can be the case. I have no questions because you have answered every question in the course of your statement.

Senator D'Amato.

Senator D'AMATO. Let me say to Congresswoman Johnson that you are to be commended for your leadership in this area and the vigor and vitality with which you address this problem, not only in your State, but in your work in the past.

What is your reaction to the President's decision to defer action upon the bearing industry's section 232 national security petition, and what is the risk in not taking action to protect this industry?

Representative JOHNSON. Certainly if there were no action taken at all, it would be very serious. I was disappointed in a decision to defer, but I agree with Secretary Verity that we do need to look very closely in the next couple of months at the initial impact of the buy-American regulations. We need to get the dumping margin information out there, and we need to act strongly on this dumping petition. And then we also need to act on the 232 petition.

But one does not substitute for the other. The dumping issue is a separate issue from national security. That is breaking of American law. Dumping is a fairness and competition issue, while the 232 petition addresses national security. While I can tolerate deferring action on the 232 for a couple of months, I do not think that we can act on dumping and not act on the separate national security question. And we would not have written the buy-American provisions if we did not see that national security was truly in jeopardy, and that is why this hearing today is going to help us move forward.

Senator D'AMATO. Well, now, there seems to be developing as a result of, I think, past problems in our own manufacturing industries, a concept that whenever American industries or Congress raise questions about fairness, about dumping, about margins, that somehow that this is a bailout, that we are attempting to bail out industries that are noncompetitive, that cannot compete. Would you respond to that idea as it relates to the criticisms that foreign manufacturers are now raising with respect to the investigation of bearing imports being dumped into U.S. markets and threatening our national security?

Do you equate this, and those of us who raised these questions, with the idea that somehow the manufacturers are seeking a bailout?

Representative JOHNSON. Well, I think that the evidence will demonstrate very clearly that there has been dumping in the clearest and most precise meaning of that word, and unfair competition. Prices have not reflected the currency value changes, and there is no way that the current prices could be said to be covering costs.

I think there clearly is unfairness, as we have found in many other industries, and we have chapter and verse now on how unfairness has threatened America's semiconductor industry. A few years ago it was argued that when American businesses asked for Government support and strong policies to implement our own laws, that they were crying weak sister and that if they were really competitive, they would not need that assistance.

We know better now. We know that just as we had antitrust laws governing the American market to ensure fairness in domestic competition, so, too, we need rules that guarantee same degree of fairness in the international market.

Eventually, we will have to step back on the word "fairness" because it implies a moral judgment of other nations which is neither healthy nor useful. Nonetheless, it is absolutely true that Japan does business differently than we do. And Japan's Government can provide assistance to Japanese business in a way that the American Government cannot, and that gives a price advantage in the marketplace.

Those are the kinds of issues that I think we need to address by aggressively enforcing our dumping laws, by aggressively forcing market access issues, and, until we do get those things in place, by taking strong action on the 232 petition.

So, the simple answer to your question is no, I do not believe American industry is a weak sister because they need Government policies that ensure the enforcement of our own laws. I do not think American industry is a weak sister because it cannot compete with a totally different kind of competition from other nations that in our own domestic market would be illegal by definition.

I think we do need, and our industry does deserve, national policies that assure it has the opportunity to compete on the same terms that we compete in our own domestic market. That is our job right here, and that is why I appreciate your holding these hearings.

Senator D'AMATO. Thank you very much. I want to compliment you on the fairness of your response because it is long overdue, and I deeply appreciate it. I think that those in industry are sensitive to this charge, because, again, there may have been some legitimate questions about whether or not in years gone by Americans had the industrial productivity we need to be competitive. I think that we have almost begun to adopt this philosophy that we cannot compete. There is the issue of fairness, the issue of compliance with foreign laws affecting our exports. I'm not even going into the nontariff barriers that are set up in foreign marketplaces, whether culturally or deliberately. I think the cultural thing is a lot of nonsense, that there is a lot of deliberateness behind those barriers. It is important that we understand that we can compete, that we indeed can win. Indeed, we can win in terms of precision, in terms of quality, in terms of price, but we cannot do it if we have the deck stacked against us. It is about time that we stopped apologizing for seeking fair play. I thank you.

Senator WEICKER. I want to thank you, Nancy, and again I also might add for making the point of differing between the national security aspect of the problem and the dumping aspect of the problem. They are separate and apart.

So that my attitudes are not taken amiss here, I want to make it clear from my vantage point nobody is intending to come down on the heads of Japan or any particular nation. I have got to tell you I come from the point of view that when it comes to the quantity and quality of bearings related to our national defense, I do not want to rely on any nation, on any nation. That is something that we should have the capacity to turn out ourselves. So, this is not directed toward any particular country, and I think I should make that clear.

And I think it is also important as you have made it clear that there are two different problems that we are addressing here this morning, both the dumping and the national security aspects of the problem. Thank you very much.

Our next witness is the Commissioner of the U.S. Customs Service, William von Raab; Shelley Altenstadter, the director of commercial fraud enforcement; and Mr. William Dean, the senior special agent in Los Angeles.

It is a pleasure to have you here, Commissioner. I think maybe the best way to handle this is to allow you to proceed in whichever way you care to with your team, and we will take it from there as to questions.

STATEMENT OF WILLIAM VON RAAB, COMMISSIONER, U.S. CUSTOMS SERVICE, WASHINGTON, DC, ACCOMPANIED BY SHELLEY ALTENSTADTER, DIRECTOR, COMMERCIAL FRAUD ENFORCEMENT, AND WILLIAM DEAN, SENIOR SPECIAL AGENT, LOS ANGELES, CA

Mr. VON RAAB. Thank you very much. It is a pleasure for me to be here. I cannot let the opportunity pass by asking one of those questions that seem to be asked regularly. Where are the Democrats? But it is nice to appear before two Republicans for a change.

Senator WEICKER. You have already accorded me an honor that not all accord me, Mr. von Raab.

Mr. VON RAAB. This is my first opportunity to appear before you, Mr. Chairman, but it is a very frequent pleasure for me to appear before Senator D'Amato with whom I am usually dealing on drug issues, because one of the least best kept secrets in this country is that if we do have a drug czar in the United States, it is probably Al D'Amato. Sometimes I think he is sort of my uncle when it comes to drug matters because he is on the phone with me just about every other day asking me what is going on. However, it is very nice for Customs to be able to describe some of its other programs which are particularly important for protecting our economy and in effect the national health.

As you indicated earlier, at my right is special agent Shelley Altenstadter, who is the head of our trade fraud program, and she is basically responsible for some 500 Customs agents and import specialists who are responsible for monitoring, investigating, and bringing to prosecution violations of our trade laws like those that we are going to be speaking about here.

On my left is special agent William Dean from our Los Angeles office. He will be able to help you to some degree obviously given your previous concern, which we share, about protecting our criminal cases, and I think he will be able to highlight some of the problems that we face in some of our cases.

In the past, we have emphasized in Customs revenue protection in our commercial enforcement programs. In recent years there has been a subtle change in the methods by which the United States has sought to regulate importation. Increasingly, import tariffs have been supplemented or replaced by nontariff controls such as negotiated quotas or voluntary restraints. Dumping, that is, the entry of foreign merchandise into the United States at a value far below the fair market value in the country of origin, has long been prohibited. Over the years, many methods have been utilized to identify dumping and implement antidumping duties to protect our domestic industries from these unfair practices.

Many of Customs' successful fraud cases have documented complex schemes to conceal dumping and evade any dumping duties. We have continually adapted our commercial enforcement programs to address changes in the methods by which unscrupulous traders and importers have sought to circumvent our trade policies and evade import and related tariffs. At one time our examination and investigative efforts concentrated on schemes to avoid payment of import duties. We have, however, expanded our efforts, and now we also target the ever evolving fraudulent schemes to circumvent our country's changing methods of regulating imports.

A good example is our national steel fraud program and it shows how we can continually adapt to enforce the variety of steel trade controls that have been implemented over time. The worldwide steel manufacturing glut of the late seventies and early eighties provided a powerful temptation to sell various steel products to us at less than fair market value.

In response, Commerce instituted the trigger price mechanism as a method of monitoring the possible dumping of these prices. As a result, several unscrupulous exporters and importers developed schemes to evade the TPM by declaring falsely high sales prices to U.S. Customs and misdescribing steel products.

Customs responded by initiating a multidisciplined approach to the problem. Significant criminal sanctions and civil recoveries have been obtained against the violators. Most impressively to date, Mitsui pled guilty to 21 criminal violation counts and paid $11.2 million in fines and penalties.

In the Daewoo case, criminal convictions were obtained on the company and its president on March 6. And the Government brought suit in the International Court of Trade against Daewoo in the amount of over $160 million.

Since the end of TPM, restraint agreements have been negotiated with individual supplier nations. We now have restraint agreements on steel products with the European community and with 18 other countries.

Price manipulations are no longer the only strategy of steel trade violators. We now find evidence of transshipment of controlled steel products from countries with which we have negotiated import limits through other countries with which we have none to conceal the actual country of origin on entry into the United States.

In the future months we will be seeing criminal and civil actions against companies and individuals involved in these practices. Additionally, because the voluntary restraint agreements are quantitative restraints, we have found instances where the quantities have been understated on the import documentation. Several seizures have been made as we have developed methods to identify these schemes.

Although quantity restraints have supplemented and in some cases replaced value controls in many of the steel commodities and in the textile trade area, dumping is obviously still a common practice in a wide variety of commodities. Customs collects import statistics including quantity and value for the use of other domestic agencies. The Government no longer independently initiates antidumping investigation, but instead acts on complaints of dumping and injury from domestic industry. The figures collected by Customs are relied on during preliminary reviews in dumping investigations. If dumping is verified by the Department of Commerce, investigation in dumping margins are established. The United States collects the resulting antidumping duties.

The declaration to Customs of a false description of merchandise or a false value for that merchandise to evade a finding of dumping or antidumping duties is a materially false statement within our jurisdiction. Criminal conviction and civil penalties for this type of violation is a continuing priority of our service. We currently have nine active investigations with allegations involving false statements to evade antidumping. So far in the fiscal year of 1988 we have invested more than 6,000 investigative hours in this area.

As of August 1, 1988, the Customs Service was actively investigating 3,430 trade fraud cases. We had issued 130 summonses and executed 113 search warrants in furtherance of these investigations. By August 1 we had seized over $20 million worth of merchandise for copyright or trademark violations, and we had seized $46 million worth of textiles for various customs violations.

We have increased the dedication of our available resources to our fraud program. We are continually improving the effectiveness of our commercial enforcement efforts. Our antifraud success depends on a close interaction with the private sector of the U.S. economy which is frequently the victim of fraudulent practices by importers.

Mr. Chairman, in closing let me reiterate that we strongly support our commercial fraud enforcement programs. It is one of the Customs Service's top four enforcement priorities. Our fraud enforcement program protects American industries from foreign competitors who engage in illegal activity that threatens the viability of American industry and protects American consumers from shoddy products masquerading as meeting American standards. Our record is a proud one. We have had many successes, and we have come a long way. As the changing pattern of illegal trade practices evolves, Customs will continue to meet its obligation of enforcing our trade laws and to address the challenges of the future. I, of course, am looking forward to answering any questions you may have. Thank you very much.

[The prepared statement of Mr. von Raab follows:]

STATEMENT OF

COMMISSIONER WILLIAM VON RAAB

U.S. CUSTOMS SERVICE

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS

SEPTEMBER 8, 1988

MR. CHAIRMAN, I AM HAPPY TO BE APPEARING BEFORE YOU TODAY TO DISCUSS THE ROLE OF THE CUSTOMS SERVICE IN INVESTIGATING COMMERCIAL FRAUD VIOLATIONS WHICH INJURE OUR DOMESTIC INDUSTRIES. I AM ALWAYS PLEASED TO SEE MY GOOD FRIEND, SENATOR D'AMATO, ONE OF THE LEADING FIGHTERS IN THE SENATE IN OUR NATION'S WAR AGAINST DRUGS.

HISTORICALLY THE CUSTOMS SERVICE EMPHASIZED REVENUE PROTECTION IN OUR COMMERCIAL ENFORCEMENT PROGRAMS. IN RECENT YEARS, THERE HAS BEEN A SUBTLE CHANGE IN THE METHODS BY WHICH THE UNITED STATES HAS SOUGHT TO REGULATE IMPORTATION. INCREASINGLY, NON-TARIFF CONTROLS ARE BEING USED. DUMPING, THE ENTRY OF FOREIGN MERCHANDISE INTO THE UNITED STATES AT A VALUE BELOW THE FAIR MARKET VALUE IN THE COUNTRY OF ORIGIN, HAS LONG BEEN PROHIBITED. OVER THE YEARS MANY METHODS HAVE BEEN UTILIZED TO IDENTIFY DUMPING AND IMPLEMENT ANTI-DUMPING DUTIES TO PROTECT OUR DOMESTIC INDUSTRIES FROM THIS UNFAIR TRADE PRACTICE. MANY OF CUSTOMS SUCCESSFUL FRAUD CASES HAVE DOCUMENTED COMPLEX SCHEMES TO CONCEAL DUMPING AND TO EVADE ANTI-DUMPING DUTIES.

WE HAVE CONTINUALLY ADAPTED OUR COMMERCIAL ENFORCEMENT PROGRAMS TO ADDRESS CHANGES IN THE METHODS BY WHICH UNSCRUPULOUS TRADERS AND IMPORTERS HAVE SOUGHT TO CIRCUMVENT OUR TRADE POLICIES AND EVADE IMPORT AND RELATED TARIFFS. AT ONE TIME, OUR EXAMINATION AND INVESTIGATIVE EFFORTS CONCENTRATED ON SCHEMES TO AVOID PAYMENT OF IMPORT DUTIES. WE HAVE EXPANDED OUR EFFORTS AND NOW WE ALSO TARGET THE EVER EVOLVING FRAUDULENT SCHEMES TO CIRCUMVENT OUR COUNTRIES CHANGING METHODS OF REGULATING IMPORTS.

NATIONAL STEEL FRAUD PROGRAM

Our National Steel Fraud Program is an excellent example of our continuing adaptation to enforce the variety of steel trade controls that have been implemented over time. The worldwide steel manufacturing glut of the late 1970's and early 1980's provided a powerful temptation to sell various steel products to the United States at less than fair market value. In response, the Department of Commerce instituted the "Trigger Price Mechanism" (TPM) as a method of monitoring the possible dumping of these products. As a result, several unscrupulous exporters and importers developed schemes to evade the TPM by declaring falsely high sales prices to U.S. Customs and misdescribing steel products.

Customs responded by initiating a multidisciplined approach to the problem. Significant criminal sanctions and civil recoveries have been obtained against the violators - most impressively, to date, MITSUI pled guilty to 21 criminal felony counts and paid $11.2 million in fines and penalties. In the DAEWOO case, criminal convictions were obtained on the company and its president and on March 6, the Government brought suit in the Court of International Trade against DAEWOO in the amount of $163,065,386.

Since the end of TPM, restraint agreements have been negotiated with individual supplier nations. We now have restraint agreements on steel products with the European Community and 18 other countries. Price manipulations are no longer the only strategy of steel trade violators. We now find evidence of transshipment of controlled steel products from countries with which we have negotiated import limits through

OTHER COUNTRIES WITH WHICH WE HAVE NONE TO CONCEAL THE ACTUAL COUNTRY OF ORIGIN ON ENTRY INTO THE UNITED STATES. IN THE FUTURE MONTHS, WE WILL BE SEEING CRIMINAL AND CIVIL ACTIONS AGAINST COMPANIES AND INDIVIDUALS INVOLVED IN THESE PRACTICES. ADDITIONALLY, BECAUSE THE VOLUNTARY RESTRAINT AGREEMENTS ARE QUANTITATIVE RESTRAINTS, WE HAVE FOUND INSTANCES WHERE THE QUANTITIES HAVE BEEN UNDERSTATED ON THE IMPORT DOCUMENTATION. SEVERAL SEIZURES HAVE BEEN MADE AS WE HAVE DEVELOPED METHODS TO IDENTIFY THESE SCHEMES.

DUMPING VIOLATIONS

THOUGH QUANTITY RESTRAINTS HAVE SUPPLEMENTED AND, IN SOME CASES, REPLACED VALUE CONTROLS IN MANY OF THE STEEL COMMODITIES AND IN THE TEXTILE TRADE AREA, DUMPING IS STILL A COMMON PRACTICE IN A WIDE VARIETY OF COMMODITIES. CUSTOMS COLLECTS IMPORT STATISTICS INCLUDING QUANTITY AND VALUE FOR THE USE OF OTHER DOMESTIC AGENCIES. THE GOVERNMENT NO LONGER INDEPENDENTLY INITIATES ANTI-DUMPING INVESTIGATIONS, BUT INSTEAD ACTS ON COMPLAINTS OF DUMPING AND INJURY FROM DOMESTIC INDUSTRY. THE FIGURES COLLECTED BY CUSTOMS ARE RELIED ON DURING PRELIMINARY REVIEWS AND DUMPING INVESTIGATIONS. IF DUMPING IS VERIFIED BY THE DEPARTMENT OF COMMERCE INVESTIGATION AND DUMPING MARGINS ARE ESTABLISHED, U.S. CUSTOMS COLLECTS THE RESULTING ANTI-DUMPING DUTIES. THE DECLARATION TO CUSTOMS OF A FALSE DESCRIPTION OF MERCHANDISE OR A FALSE VALUE FOR THAT MERCHANDISE TO EVADE A FINDING OF DUMPING OR ANTI-DUMPING DUTIES, IS A MATERIALLY FALSE STATEMENT WITHIN OUR JURISDICTION. CRIMINAL CONVICTION AND CIVIL PENALIZATION FOR THIS TYPE OF VIOLATION IS A CONTINUING PRIORITY OF OUR SERVICE.

WE CURRENTLY HAVE NINE ACTIVE INVESTIGATIONS WITH ALLEGATIONS INVOLVING FALSE STATEMENTS TO EVADE ANTI-DUMPING. SO FAR IN FISCAL YEAR 1988, WE HAVE INVESTED MORE THAN 6,000 INVESTIGATIVE HOURS IN THIS AREA.

FISCAL YEAR 1988 COMMERCIAL FRAUD STATISTICS

AS OF AUGUST 1, 1988, THE CUSTOMS SERVICE WAS ACTIVELY INVESTIGATING 3430 COMMERCIAL FRAUD CASES. WE HAD ISSUED 130 SUMMONS AND EXECUTED 113 SEARCH WARRANTS IN FURTHERANCE OF THESE INVESTIGATIONS. BY AUGUST 1, WE HAD SEIZED $21,585,964 WORTH OF MERCHANDISE FOR COPYRIGHT/TRADEMARK VIOLATIONS. WE HAD SEIZED $46,669,111 WORTH OF TEXTILES FOR VARIOUS CUSTOMS VIOLATIONS.

THE CUSTOMS SERVICE HAS INCREASED THE DEDICATION OF OUR AVAILABLE RESOURCES TO OUR COMMERCIAL FRAUD PROGRAM. WE ARE CONTINUALLY IMPROVING THE EFFECTIVENESS OF OUR COMMERCIAL ENFORCEMENT EFFORTS. OUR ANTI-FRAUD SUCCESS DEPENDS ON A CLOSE INTERACTION WITH THE PRIVATE SECTOR OF THE U.S. ECONOMY, WHICH IS FREQUENTLY THE VICTIM OF FRAUDULENT PRACTICES BY IMPORTERS.

MR. CHAIRMAN, IN CLOSING LET ME REITERATE THAT WE STRONGLY SUPPORT OUR COMMERCIAL FRAUD ENFORCEMENT PROGRAM. IT IS ONE OF THE CUSTOMS SERVICE'S TOP FOUR ENFORCEMENT PRIORITIES. OUR FRAUD

ENFORCEMENT PROGRAM PROTECTS AMERICAN INDUSTRY FROM FOREIGN COMPETITORS WHO ENGAGE IN ILLEGAL ACTIVITY THAT THREATENS THE VIABILITY OF AMERICAN INDUSTRY AND PROTECTS AMERICAN CONSUMERS FROM SHODDY PRODUCTS MASQUERADING AS MEETING AMERICAN STANDARDS.

OUR RECORD IS A PROUD ONE. WE HAVE HAD MANY SUCCESSES. WE HAVE COME A LONG WAY. AS THE CHANGING PATTERN OF ILLEGAL TRADE PRACTICES EVOLVES, THE CUSTOMS SERVICE WILL CONTINUE TO MEET ITS OBLIGATION OF ENFORCING OUR TRADE LAWS AND TO ADDRESS THE CHALLENGES OF THE FUTURE. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Questions from Senator Weicker and answers by Mr. Von Raab

QUESTION 1:

In this investigation, was there information or evidence found that Customs considered to be of interest to other agencies? Which agencies were offered this information?

ANSWER: Customs contacted DCIS from the outset and DCIS was there participating in the search warrant. There has been and continues to be constant contact and coordination between DCIS and Customs. The sharing of leads, information and ideas is continuous and mutually beneficial. As we discussed earlier, our case agent felt that some of the documents might be useful to Commerce. These were offered to Commerce, and Commerce has been evaluating the extent to which they can use these documents.

QUESTION 2:

Has the Commerce Department requested and received materials uncovered in this investigation yet? When?

ANSWER: Commerce was offered "dumping documents" and production cost charts that were found during the search of NMB. Commerce questions whether or not they can make use of these documents in their investigation. The case agent has been told the documents may not help them. The Commerce Chief Counsel received the documents from Customs on September 6, 1988. Commerce has been offered the opportunity to read, copy and use the seized documents for any pertinent information. So far, they have not looked for any other documents and the offer to look remains open. Customs remains willing to share all of the seized documents and computer data.

Questions from Senator D'Amato and answers by Mr. Von Raab

QUESTION 1:

Has the Customs Service discussed with the Department of Defense the problems posed to our National Security by predatory and illegal business practices by foreign companies aimed at industries that are critical to our national security?

ANSWER: When the Customs Service becomes aware of a possible criminal action that could be of interest to the Defense Department we notify them through the appropriate channels and we traditionally work closely with them on such cases. As I mentioned earlier, commercial fraud is one of the Customs services top four investigative priorities, and that is because of the critical importance to our economic well being and national security of the domestic industries being adversely affected.

QUESTION 2:

Do you think it would be wise to make a special effort to examine foreign attempts to dominate industries and industry segments that are vital to our national security?

ANSWER: Yes, provided that sufficient evidence of the existence of such attempts can first be demonstrated. In order to examine foreign attempts to dominate U.S. industries and industry sectors vital to U.S. national security, such attempts must of course first be identified.

QUESTION 3:

In your review, do executive branch agencies cooperate well in dealing with predatory or illegal activities by foreign manufacturers?

ANSWER: I have no complaints with the cooperation we are receiving from other federal agencies.

QUESTION 4:

Now that the Department of Commerce has at least decided to examine some of the information you seized in the raid on NIPPON MINIATURE BEARING's, Chatsworth Plant, do you believe cooperation between Customs and Commerce will improve?

ANSWER: Your question implies that there has been a problem between Commerce and Customs in this investigation. I believe that is an incorrect perception. Commerce believes that they should not accept the documents for their case without a clear law authorizing them to do so. Their reluctance to take the documents is a technical issue and does not reflect any problem between the agencies.

QUESTION 5:

Can you tell us about your efforts to persuade the Department of Commerce, before which both a Section 232 Petition and a Section 301 Petition are pending, to examine the materials your investigation uncovered?

ANSWER: Contacts were made with several Department of Commerce (DOC) official during November 1987 through September 1988.

During 1987 Special Agent William Dean spoke with several DOC officials concerning the investigation. DOC forwarded a report titled "The Bearing Industry" to Special Agent Dean.

A search warrant was executed June 1988, and Department of Commerce was apprised of the results. Also during June 1988, Special Agent Dean contacted or was contacted by the DOC Program Manager, and an attorney from DOC Chief Counsel's office. Special Agent Dean mailed documents related to this investigation to DOC.

During July 1988, Special Agent Dean discussed the investigation with Director of Office of Investigation, DOC. A conference telephone call was held with several DOC officials and the case was discussed.

During August 1988, Special Agent Dean was contacted by Director, Office of Investigation, DOC. Discussions centered on DOC authority to receive data seized during execution of the search warrant.

During September 1988, dumping documents obtained during the search warrant were sent to DOC Chief Counsel for review. Customs remains willing to share all of the seized documents and computer data.

Senator **Weicker**. Thank you. A few points should be addressed. In July staff from this Committee and my office traveled to Los Angeles to review an ongoing investigation of two companies, Nippon Miniature Bearing Corp. and New Hampshire Ball Bearing Corp. In Los Angeles, Mr. William Dean, special agent for the U.S. Customs Service, Miss Marietta Condon, special agent of the Defense Department Criminal Investigative Service, and their superiors gave a thorough briefing on this ongoing investigation of the importation and sale of bearings in this country by the two companies and their parent company, the Minebea Corporation of Japan.

In the course of this investigation a search warrant was obtained and used by Customs and the Department of Defense to search and confiscate a large number of documents from a manufacturing and distribution plant of Nippon Miniature Bearings in Chatsworth, CA.

The Committee is very aware of the sensitivity of public statements made in relation to this investigation. Consulting with the Customs Service and the U.S. Attorney's office for the Central District of California, the committee does not intend to disclose any materials involved in this case other than those publicly available. This committee does not intend to hinder the abilities of Customs or the Department of Defense in pursuing this investigation to the fullest.

The following questions are asked under these constraints that are understood. First, I would like to go ahead and place into the record the affidavit heretofore mentioned.

[Affidavit follows:]

AO 93 (Rev. 6/82)

SEAR WARRANT ON WRITTEN AFFIDA

United States District Court	DISTRICT CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA
v.
premises known as NMB at 9730 Independence A nue in Chatsworth, California

DOCKET NO.

MAGISTRATE'S CASE NO. 88-758M

CLERK, U.S. DISTRICT COURT
MAY 27 1988
CENTRAL DISTRICT OF CALIFORNIA
BY Ydg DEPUTY

TO: any Special Agents of United States Customs and DCIS or any other authorized officer

Affidavit(s) having been made before me by the below-named affiant that he/she has reason to believe that **on the premises known as** a commercial complex on one piece of land bounded by Independer and DeSoto Avenues on the east and west and Superior Street on the south in the city of Chatsworth, California. There are three commercial buildings in this complex which contain the offices, factory and warehouse of NMB and NHBB corporations. The NMB headquarters at 9730 Independence Avenue is a one and two story concrete block building with dark green walls and gold trim. It has the numbers 9730 on the front door and a sign on the lawn that reads "NMB CORP". Behind that building is a one story building with NMB and 9727 (DeSoto) on the front wall. The walls are painted an off white color SEE ATTACHED SHEET in the CENTRAL District of CALIFORNIA

there is now being concealed certain property, namely:

Entry documents including invoices, customer orders, orders to overseas suppliers and resale of imported ball bearings which follow specific orders from beginning to end.
Letters, memorandums, telexes, teletypes, thermofaxes, and other correspondence, etc. relating to bearing and component costs, pricing, descriptions of imported bearings and Customs duties. Data sheets showing the quality of ball bearings.
Original computer tapes, discs, etc. that contain data about production; purchases of shields, steel, bearings and components; prices, imports, orders, sales and inventory dating back to January 1985. User manuals for the above described computer data.
Certification of domestic orgin documents and matching contracts and/or purchase orders for sales of foreign bearings sold to either DOD or a DOD contractor.
Roster of employees and officers (past and present) showing job descriptions and residence addresses.
Documents showing purchases, consumption and resale of ball bearing steel dating back to January 1985.
Records of shields manufactured or purchased that were marked NMB and NHBB.
Loose shields that show a foreign country of origin. Used boxes, packages, and tubes that are marked with a foreign country of origin.
NMB and NHBB labels that show no country of origin or domestic origin. Boxes, tubes or packages that do not show any country of origin. Labels showing domestic or no country of origin.

and as I am satisfied that there is probable cause to believe that the property so described is being concealed on the person or premises above-described and the grounds for application for issuance of the search warrant exist as stated in the supporting affidavit(s).

8

YOU ARE HEREBY COMMANDED to search on or before ten (10) days (not to exceed 10 days) the person or place named above for the property specified, serving this warrant and making the search (in the daytime — 6:00 A.M. to 10:00 P.M.) (at any time in the day or night)* and if the property be found there to seize it, leaving a copy of this warrant and receipt for the property taken, and prepare a written inventory of the property seized and promptly return this warrant to the duty U.S. Magistrate as required by law.
U.S. Judge or Magistrate

NAME OF AFFIANT William Dean William Dean, Special Agent	SIGNATURE OF ~~JUDGE~~** OR US MAGISTRATE	DATE/TIME ISSUED 5-27-88 9:57 am

*If a search is to be authorized "at any time in the day or night" pursuant to Federal Rules of Criminal Procedure Rule 41(c), show reasonable cause therefor

**United States Judge or Judge of a State Court of Record.

BJH

ATTACHED SHEET

and the front windows are backed with a blue color material. The warehouse building is a two story concrete building with no numbers and no windows. It is grey and light grey in color and has NMB on the wall. All three buildings described above are shown in the attached photographs which are marked B.

AO 106

AFFIDAVIT FOR SEARCH WARRANT

United States District Court	DISTRICT CENTRAL DISTRICT OF CALIFORNIA
United States of America vs. premises known as NMB at 9730 Independence Avenue in Chatsworth, California	DOCKET NO.
	MAGISTRATE'S CASE NO. 88-758M
	NAME AND ADDRESS OF JUDGE[1] OR U.S. MAGISTRATE United States Magistrate Los Angeles, California.

The undersigned being duly sworn deposes and says: That there is reason to believe that

☐ on the person of ☒ on the premises known as

DISTRICT
CENTRAL DISTRICT OF CALIFORNIA

a commercial complex on one piece of land bounded by Independence and DeSoto Avenues on the east and west and Superior Street on the south in the city of Chatsworth, California. There are three commercial buildings in this complex which contain the offices, factory and warehouse of NMB and NHBB corporations. The NMB headquarters at 9730 Independence Avenue is a one and two story concrete block building with dark green walls and gold trim. It has the numbers 9730 on the front door and a sign on the lawn that reads "NMB CORP." see attached

The following property (or person) is concealed:

Entry documents including invoices, customer orders, orders to overseas suppliers and resale of imported ball bearings which follow specific orders from beginning to end.

Letters, memorandums, telexes, teletypes, thermofaxes, and other correspondence relating to bearing and component costs, pricing, descriptions of imported bearings and Customs duties. Data sheets showing the quality of ball bearings.

see attached sheet

Affiant alleges the following grounds for search and seizure[2]

which are the fruits, instrumentalities, and evidence of violation of Title 18 USC 1001 and 18 USC 545.

☐ See attached affidavit which is incorporated as part of this affidavit for search warrant

Affiant states the following facts establishing the foregoing grounds for issuance of a Search Warrant

(SEE ATTACHED AFFIDAVIT WHICH IS INCORPORATED AS PART OF THIS AFFIDAVIT FOR SEARCH WARRANT)

SIGNATURE OF AFFIANT William Dean
William Dean

OFFICIAL TITLE, IF ANY
Special Agent, U.S. Customs

Sworn to before me, and subscribed in my presence:

DATE 5-27-88 9.57a.m.

JUDGE[1] OR U.S. MAGISTRATE

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[1] United States Judge or Judge of a State Court of Record.

[2] If a search is to be authorized "at any time in the day or night" pursuant to Federal Rules of Criminal Procedure 41(c), show reasonable cause therefor.

BJH

AFFIDAVIT

I, William Dean, being duly sworn hereby depose and say:

1. I am a Special Agent (S/A) of the United States Customs Service (Customs.) I have been a federal agent conducting both criminal and civil investigations for over 18 years. Over these many years I have worked a variety of criminal and civil cases for the Bureau of Narcotics and Dangerous Drugs, Drug Enforcement Administration and U.S. Customs. I have interviewed numerous criminal informants, cooperative and uncooperative citizens and people of various professions during the course of many investigations.

2. For the last two years I have been assigned to the fraud group in the Los Angeles Customs office. During this time I have completed or worked on 42 separate fraud investigations that were assigned to me. I have investigated cases where the merchandise was undervalued by the importer to pay less Customs duty. I have had cases where the importer misdescribed the merchandise to avoid quota restrictions or to pay less duty. I have seen instances where the importers used one or several subterfuges to circumvent Customs laws and duties. I have received formal training in fraud at the advanced agent school at Glynco, Georgia and have attended fraud seminars for additional training.

3. This affidavit is made in support of an application for a search warrant. The warrant is for the corporate offices, factory and warehouse of NIPPON MINIATURE BEARING and NEW /

HAMPSHIRE BALL BEARING at 9730 Independence Avenue in Chatsworth, California. The allegations which I am investigating concern: (1) the importation of foreign bearings at a false declared value and (2) the re-marking of foreign bearings as domestic bearings and then certifying the imported bearings to the Department of Defense as domestic made bearings. This search is necessary to obtain evidence of violations of 18 USC 1001, and 18 USC 545 by NIPPON MINIATURE BEARING, NEW HAMPSHIRE BALL BEARING and MINEBEA.

4. On May 20, 1988 I spoke with Mr. A.J. Sperrazza who has provided me with information on many prior occasions during this investigation. Mr. Sperrazza told me the following:

a. He has been in the bearing business for about 20 years and lived in Japan for three of those years.

b. He has been in many foreign bearing plants and has imported bearings from Japan. He is familiar with both foreign and domestic bearing production.

c. In 1984 he owned a single company, Pacamore, which imported and re-sold bearings. He decided to start a second company, Kubar, to manufacture miniature precision bearings in Troy, New York.

d. Takami TAKAHASHI is the founder of MINEBEA COMPANY (MINEBEA) of Japan which produces ball bearings overseas. MINEBEA bought a bearing company in Chatsworth many years ago and created a new bearing company called NMB. MINEBEA supplies NMB with foreign made bearings. NMB bought an East Coast ball bearing manufacturer called New Hampshire Ball Bearing (NHBB) about three years ago.

5. On December 4, 1987 I met with Mr. Sperrazza in person and reviewed information he had provided me over the telephone during prior conversations. During that meeting he confirmed the following:

(a) In 1984 or 1985 it became known in the bearing industry that Pacamor planned to start a new factory which would make miniature precision bearings in Troy, New York.

b) An executive officer of NMB, Mr. Ishikawa, came to New York to talk with Mr. Sperrazza about the new venture. Mr. Sperrazza said that Mr. Ishikawa tried to persuade him to not make miniature precision bearings by offering him NMB made bearings in Pacamore boxes at low prices.

(c) Mr. Sperrazza told me that when he said he would continue with the venture, Mr. Ishikawa said that Pacamore could not compete with NMB because NMB could make bearings cheaply in Singapore.

(d) Mr. Sperrazza said that his market would be domestic bearings for defense application. Mr. Ishikawa responded that the NMB Chatsworth plant was a "washing machine" and that foreign made bearings would go in the back door and out the front door.

(e) Mr. Sperrazza told me that he understood this to mean that foreign bearings would be imported to the NMB plant in Chatsworth where they would be marked as a domestic product and sold for defense applications.

6. On April 12, 1988 I received Dunn and Bradstreet (D&B) reports on NMB and NHBB. These reports showed the following:

> NMB and NHBB are both corporations owned by NMB USA which is a wholly owned subsidiary of MINEBEA of Japan. Takami TAKAHASHI is the President of MINEBEA and a director of NHBB. Hidisato ISHIKAWA is an executive vice-president of MINEBEA and the President of NMB. NHBB manufactures ball and rod end bearings and its 1987 projected sales were $160,000,000. NMB declined to provide financial information so I do not have figures about NMB gross sales.

7. I have received a computer data printout of NMB imports from the Customs Headquarters in Washington, D.C. I have been told by Barbara O'Keefe of the data retrieval center that from January to November of 1987 NMB imported 73,461,865 separate ball bearing units with a declared value of $28,923,891. These totals were obtained from information supplied by NMB on the import entry documents submitted to Customs with each shipment. Each ball bearing unit contains an inner and outer ring, a retainer (aka separator or cage) and several balls. The attached photocopy shows these components. (Attachment A)

8. Customs has employees who review entry documents for imported merchandise to see that duty rates are properly assessed and that Customs laws and regulations are followed. These employees are called import specialists and are assigned specific commodity lines to monitor. On May 25, 1988, I spoke with the Los Angeles Import Specialist (I.S.) Walter Sawelenko whose assigned commodity line is ball bearings. I.S. Sawelenko has been an import specialist for 13 years and has handled ball bearings for 18 months. I.S. Sawelenko told me that NMB is a big importer of ball bearings from Japan, Thailand and Singapore to Los Angeles. I.S. Sawelenko told me that the imported bearing shipments enter through Los Angeles International Airport and through the harbor and then go to the plant in Chatsworth. He also told me that he has toured the NMB ball bearing plant and seen the factory where domestic ball bearings are made.

9. I have spoken to Mr. David Stanley on the telephone and in person many times. On May 20, 1988 he confirmed the following:

a. He has 30 years experience in the bearing industry working for the United States Government in a materials engineering laboratory which tested ball bearings as part of its function. He was also the Chairman of the Department of Defense Instrument Bearing Working Group. In that capacity he received citizen complaints about the ball bearing' industry and most of these were from NMB employees who refused to be identified. Many of the complaints said that

NMB was selling foreign made ball bearings as a domestic product. The only employee who was willing to be identified was Richard Olson. Mr. Stanley told me that he was unable to prove the allegations and that no action was taken against NMB. Mr. Stanley said he is presently employed as a ball bearing consultant.

b. The assembled bearings often have shields or seals added on the sides to cover the balls. The shields hold the lubricant in and keep dirt out. These removable shields are often marked with the manufacturers initials such as NMB or NHBB and/or USA to show country of origin. I have samples of marked shields and have been told by Mr. Stanley that shields can be attached, removed or replaced. This accepted method of marking ball bearings makes it simple to change the markings. I have learned from Import Specialist Sawelenko that the other accepted way of marking ball bearings is to mark the package containing them. In this instance changing the package could change the stated origin of the bearings it contains.

c. Bearings are made in five quality levels which are called ABEC standards. The lowest quality is ABEC 1 and ABEC 9 is the highest. Most of the bearings involved here are ABEC 1, 3, 5 or 7. These standards are a measurement of minute tolerances between the parts of the bearing. These tolerances are measured in 1/10,000th of an inch and can only be measured with very specialized equipment. U.S. Customs is not able to test bearings for ABEC levels. ABEC

7 quality applications are in gyros and tracking devices, ABEC 5 and 7 applications are in computer disc drives, and ABEC 1 applications are in skateboards and fans.

d. Instrument bearings are 30mm (1.1812 inches) and smaller outside diameter and miniatures are 9mm and smaller. This is the primary NMB market and NMB and NHBB supply about 80% of the total commercial market in the United States. He did not know a percentage for their share of the military market.

10. On May 20, 1988 I talked to an individual (CI #1) who has provided me with prior information during this investigation which has been verified. He told me the following:

a. He was an NHBB employee for several years and quit in 1986. NHBB had an IBM system 38 to keep track of inventory. CI 1 told me the computer showed where bearings were made, what productions costs were and who they were sold to.

b. CI 1 worked in sales and was told by his NHBB office manager to sell foreign made bearings before domestic ones. He was told to say the foreign bearings were domestic and did so. As part of his sales job he had foreign made bearing boxes marked with labels that identified the bearings as domestic manufacture in the NMB Chatsworth plant. He also arranged for defense application customers to receive certificates of domestic origin on bearings that were foreign made. CI 1 knew the bearings were foreign made because the computer showed their origin.

c. He participated in a large sale of ball bearings in 1986 where the selling price to the domestic customer was below the overseas cost of production. This sale involved 608ZZ bearings which are a common low cost ABEC 1 quality ball bearing used in skateboards. He found the overseas production cost of these 608ZZ bearings in the NHBB computer system at 40 cents each. The domestic sale was made to the customer for 37 cents each.

11. I have reviewed NMB entry documents and found that 608ZZ bearings are entered through the port of Los Angeles valued at 23 cents each. I.S. Sawelenko told me that the duty rate on all of the bearings imported by NMB is 11% of the declared value. A declared value of 23 cents on a bearing that costs 40 cents to manufacture results in a loss of duty to Customs. This amounts to a 42% undervaluation without adding other costs and profits. During the course of my investigation I have not seen any price increases for this bearing during a period when the dollar declined against the yen. Based on my investigation it appears that NMB imports more of this size bearing than any other.

12. On May 23, 1988 I spoke with an individual (CI #2) who told me the following:

a. He worked several years for NHBB and left in 1986. NHBB kept all of its production, inventory and other data on computer tapes.

b. The NHBB Peterbrough New Hampshire plant made shields for bearings that were stamped "NHBB" and "USA." The plant made more shields than the company made bearing units and the surplus shields were sent to the Chatsworth NMB plant. He and his co-workers suspected the surplus shields were later used to re-mark foreign made bearings.

13. On December 30, 1987 I.S. Walt Sawaienko and I inspected three ocean freight shipments of imported NMB ball bearings. The entry numbers were P73-1005894-4, P73-1005895-1 and P73-1005873-8. The entry invoices list ABEC quality levels and price values as determined by NMB and/or MINEBEA. These invoices show almost all of the different types of bearings as ABEC 1 quality. The price values range from 23 cents to 40 cents per assembled bearing with most of the prices at about 25 cents each. These invoices show the 608ZZ bearing valued at 23 cents each. CI 1 told me the overseas production cost was 40 cents. It appears to me these bearings are undervalued which would cause an underpayment of Customs duties. I believe that records at the NMB headquarters in Chatsworth will show the true value of the imported bearings.

14. I.S. Sawelenko saw one carton that was marked "data" and opened it. Inside the carton he and I found a data sheet that was titled "Quality Confirmed Inspection Record" and he made

photocopies of this sheet. I took a box of bearings from that carton as a sample. The box was labeled R-4DDR to describe the size and traits of the bearing and A1 for ABEC 1, the quality level. The carton was marked the same way. The invoice described the bearings as R4DDR and ABEC 1 quality. The data sheet shows knowledge by NMB as to the true quality of these bearings.

15. On December 30, 1987, I.S. Sawelenko and I took boxes and tubes of different sizes of ball bearings from the three shipments. I kept custody of these samples and later took them to the Naval Air Station Materials Engineering Laboratory on Coronado Island near San Diego. This laboratory tests ball bearing for the U.S. Government. I gave the bearing sample to Mr. Dan Smith who has seven years experience in this laboratory.

16. On February 12, 1988 I discussed the sample bearings with Dan Smith and he told me:

(a) He and his co-workers tested bearings from 15 of the sample lots. Four of the sample lots tested were confirmed to be ABEC 1 quality which matches the invoice. One of the samples tested was ABEC 5 quality and 10 of the samples tested were ABEC 7 quality.

(b) He analyzed the sample bearings found in the carton with the data sheet and found them to be ABEC 7 quality. He studied the data sheet found with the samples and learned that it described the bearings as ABEC 7 quality.

Mr. Smith told me that he use accepted test procedures which are recognized throughout the industry.

17. I wanted to know what the quality levels of the bearings were because I learned during this investigation that high quality bearings sell for more than low quality bearings. Mr. Sperrazza provided me with estimates of domestic and Japanese production costs showing the relative costs of ABEC 1 and 7 bearings. He said that ABEC 7 bearings cost about 72 % more to manufacture than ABEC 1 bearings in the U.S. and about 95 % more in Japan. As a precaution, I got five other estimates from industry sources. One of the other estimates was about the same and four were considerably higher.

18. On May 20, 1988 I spoke with Special Agent Marietta Condon of the Defense Criminal Investigative Service (DCIS) who told me the following:

(a) The "Buy America Act" of the Department of Defense (DOD) Federal Acquisition Regulations (FAR), Clause 52.208-7000, requires that sources of miniature and instrument ball bearings destined for DOD use must be from domestic sources, in that they are wholly manufactured in the United States or Canada.

(b) The U.S. Government requires that a vendor certify that they have compiled with the governments source requirements, although on occasion the government might waive the source requirements if it is felt it is in the governments best interest. If so, this particular waiver would be noted on the contract or purchase order agreement between the vendor and the government's contracting administrator.

(c) Additionally, SA Condon told me that the Defense Industrial Supply Center (DISC) in Philadelphia commonly makes direct ball bearing purchases from NMB and NHBB.

(d) S/A Condon showed me computer print-outs entitled "CTDF - Interrogation Reply Technical Data" which she got from DISC. The print-outs show DISC ball bearing purchases from NMB and NHBB for defense contracts.

19. On May 20, 1988 I reviewed two reports authored by S/A Mike Shiohama of DCIS dated October 16, 1987. Both reports state that NMB and NHBB sell to defense contractors and named seven such contractors. On May 9, 1988 I reeived a certificate of domestic origin issued by NHBB to Douglas Aircraft Company stating that all materials and components were manufactured in the United States.

20. On May 10, 1988, I spoke with Mr. Michael Carbone on the telephone and he told me the following:

(a) He is a supervisor for the Defense Contract Administration Service (DCAS) and is the current chairman of the United States Government sponsored Instrument Bearing Working Group.

(b) For the last 20 years he has worked for the U.S. Government inspecting domestic ball bearing plants.

(c) His job is to inspect a plant through all phases of its production from the steel bar stock to testing of the finished bearing assembly. He is not a production engineer but has inspected many plants during his 20 years of service.

(d) He toured the NMB bearing plant in Chatsworth in November of 1987. Based on the equipment he saw in the plant and the activity he saw, he estimated the NMB Chatsworth production at about 300,000 assembled bearings a month.

(e) The NMB tour guide said the monthly plant production was 600,000 complete bearing units a month.

21. On May 20, 1988 I spoke with Mr. David Stanley who also toured the Chatsworth NMB plant in November 1987. Mr. Stanley told me the following:

(a) He said that the NMB guide said the monthly production rate was 600,000 bearing units. He is not a production engineer but has toured many ball bearing plants over the last 30 years.

(b) He did not believe that the plant was making that many bearings based on the equipment he saw in operation and the number of workers.

(c) He and the other visitors that he discussed production totals with estimated the monthly production capacity at less than 300,000 units.

22. I spoke to CI 1 who reviewed NMB/NHBB production figures for 1985 and 1986 when he was an NHBB employee. CI 1 told me that the Chatsworth plant production records he saw were far below the 300,000 units a month.

23. Based on my investigation, which is summarized in this affidavit, I believe the following: NMB claims more production than it actually performs so that it can sell imported foreign ball bearings as a domestic product. For example, the Chatsworth plant makes 300,000 units a month. Another 300,000 foreign bearings a month are sold as domestic to match the "announced production rate" of 600,000 units. The above described acts would constitute both Customs and DCIS violations. I believe that NMB production, import and sales records will prove these violations and want to search for these documents at the Chatsworth facility. I.S. Sawelenko, CI 1 and CI 2 have told me these records are kept on computer tapes.

24. In early May 1988 I received an in-house NMB memorandum from Mr. Sperrazza. The memorandum gave operating instructions to the NMB production and sales divisions. The production workers were told to produce more for less cost and not worry about sales. The sales people were instructed to sell bearings with almost no regard for the price. It appears that the company prepares in-house memos concerning its operations. I have been involved in fraud search warrants where the suspected individuals or companies have kept records of illegal practices. I have

discussed this investigation with two Senior Special Agents who each have years of experience in fraud investigations. Both agents have participated in numerous fraud search warrants. They told me that most searches reveal incriminating documents and records which tend to prove the suspected violations. In this instance I believe the normal business and required import records will be evidence of the violations.

25. I have been involved in investigations where documents, telexes, etc. were addressed to and sent by persons who only used a first or last name. To identify the specific employee or officer whose partial name appears on a document, I need a company roster of employee names and job descriptions. To interview employees after the search I will need home addresses where they can be contacted privately. The job description data will also preclude contacting employees who did not work in the areas where violations occurred.

26. I have discussed the NMB imports with Import Specialist Walter Sawelenko who reviews the entry documents for ball bearing entries. I.S. Sawelenko told me that he reviews the NMB entries and toured the corporate headquarters and factory in Chatsworth, California in January 1988. I.S. Sawelenko was told by an NMB employee during his tour of the premises that NMB keeps much of its data in their computer system. I.S. Sawelenko was told that NMB can follow an imported ball bearing from import to sale to an NMB customer with their computer system and has seen them do so,

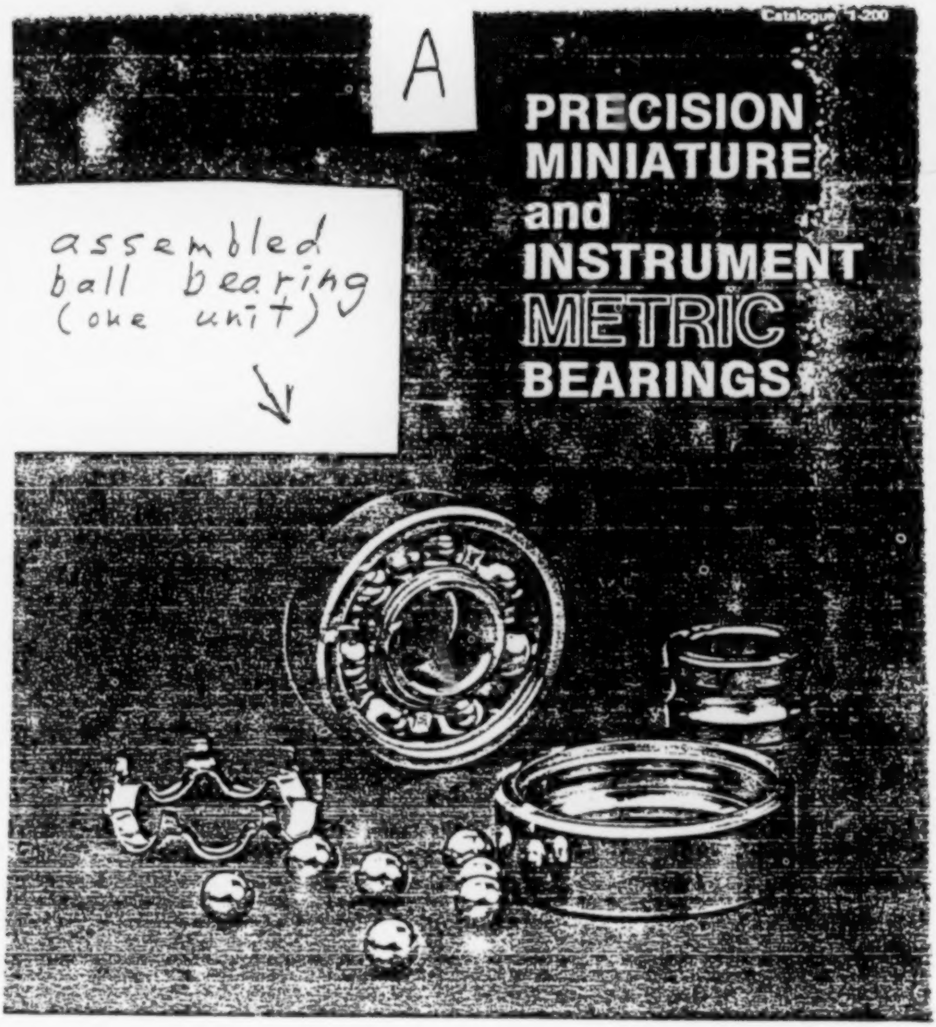
on a prior visit. I.S. Sawelenko also told me that NMB files its own entries for imports and does not use an outside Custom house broker. Customs regulations require importers to maintain import records which include entry documents. I expect these records to be kept at the corporate headquarters in Chatsworth because I.S. Sawelenko was there in the entry section talking to the employees who prepare entries and saw entry documents there.

27. I spoke with I.S. Sawelenko who described the buildings at the NMB as follows. The new grey. building was empty and under construction when he was there. He was told it would contain offices, test laboratories, and warehouse areas. The main entrance was at 9730 Independence Avenue. At that time this building contained the corporate offices, laboratories, sales offices, Customs entry section with a factory to the rear. He did not enter the building facing DeSoto and did not see the warehouse area. I took photographs of the three buildings. (Attachment B)

William Dean
Special Agent
U.S. Customs Service

Subscribed and Sworn to before me this
____ day of May 1988

Magistrate
United States District Court



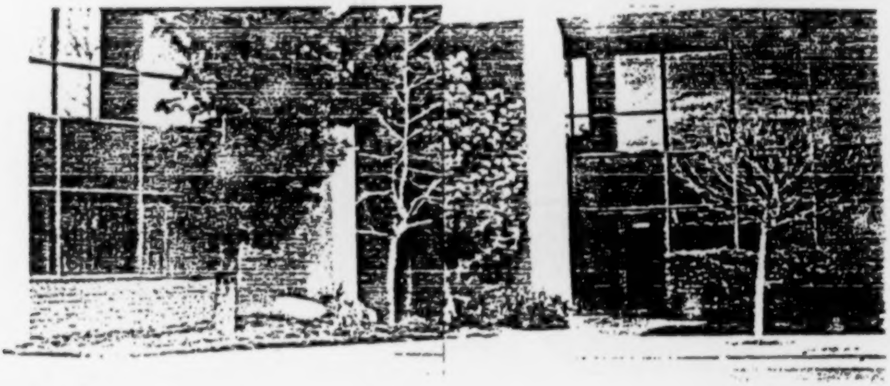
Catalogue 1-200

PRECISION
MINIATURE
and
INSTRUMENT
METRIC
BEARINGS

A
assembled ball bearing (one unit)
retainer
balls
inner + outer rings

B

NMB Corp. HQS
9730 Independence Ave
Chatsworth, CA



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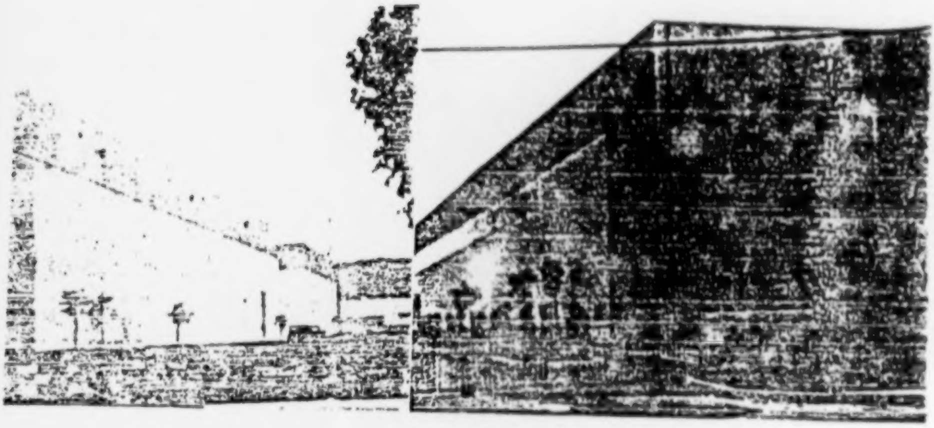
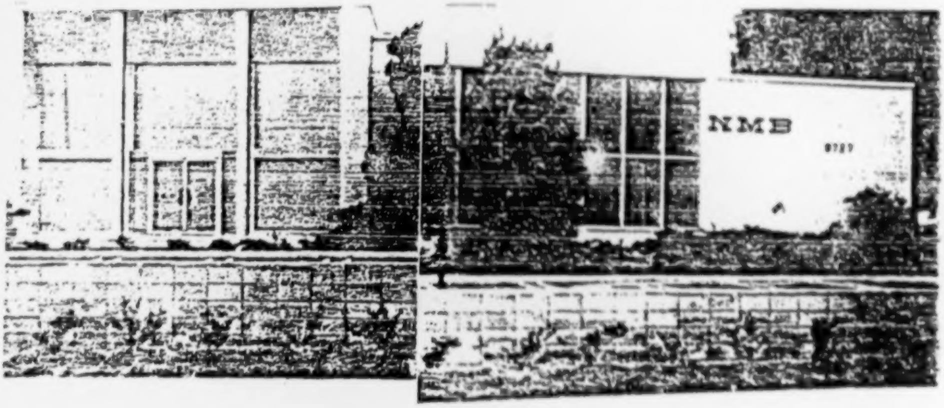


New Warehouse Bldg



9727 Desoto Avenue

RETURN

DATE WARRANT RECEIVED 5-27-88	DATE AND TIME WARRANT EXECUTED 6-1-88 9:15AM	COPY OF WARRANT AND RECEIPT FOR ITEMS LEFT WITH Richard Aalfs, VP

INVENTORY MADE IN THE PRESENCE OF
Mickey Baker, Marietta Condon

INVENTORY OF PROPERTY TAKEN PURSUANT TO THE WARRANT

computer tapes & printouts, sample boxes & labels, numerous files and documents relevant to items that were sought as named on this warrant. The attached 7 page inventory sheet contains more details.

CERTIFICATION

I swear that this inventory is a true and detailed account of all the property taken by me on the warrant.

William Dean
William Dean, Special Agent

Subscribed, sworn to, and returned before me this date.

U.S. Judge or Magistrate

6-8-88
Date
2:30pm

AO 93 (Rev. 6/82)

SEAR WARRANT ON WRITTEN AFFIDA

United States District Court	DISTRICT CENTRAL DISTRICT OF CALIFORNIA
UNITED STATES OF AMERICA v. premises known as NMB at 9730 Independence Avenue in Chatsworth, California	DOCKET NO. — MAGISTRATE'S CASE NO. 88-758M TO: any Special Agents of United States Customs and DCIS or any other authorized officers

MAY 27 1988
CLERK, U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
BY Udy DEPUTY

Affidavit(s) having been made before me by the below-named affiant that he/she has reason to believe that on the premises known as a commercial complex on one piece of land bounded by Independen and DeSoto Avenues on the east and west and Superior Street on the south in the city of Chatsworth, California. There are three commercial buildings in this complex which contain the offices, factory and warehouse of NMB and NHBB corporations. The NMB headquarters at 9730 Independence Avenue is a one and two story concrete block building with dark green walls and gold trim. It has the numbers 9730 on the front door and a sign on the lawn that reads "NMB CORP". Behind that building is a one story building with NMB and 9727 (DeSoto) on the front wall. The walls are painted an off white color SEE ATTACHED SHEET in the CENTRAL District of CALIFORNIA

there is now being concealed certain property, namely:

Entry documents including invoices, customer orders, orders to overseas suppliers and resale of imported ball bearings which follow specific orders from beginning to end. Letters, memorandums, telexes, teletypes, thermofaxes, and other correspondence, etc. relating to bearing and component costs, pricing, descriptions of imported bearings and Customs duties. Data sheets showing the quality of ball bearings.

Original computer tapes, discs, etc. that contain data about production; purchases of shields, steel, bearings and components; prices, imports, orders, sales and inventory dating back to January 1985. User manuals for the above described computer data.

Certification of domestic orgin documents and matching contracts and/or purchase orders for sales of foreign bearings sold to either DOD or a DOD contractor.

Roster of employees and officers (past and present) showing job descriptions and residence addresses.

Documents showing purchases, consumption and resale of ball bearing steel dating back to January 1985.

Records of shields manufactured or purchased that were marked NMB and NHBB.

Loose shields that show a foreign country of origin. Used boxes, packages, and tubes that are marked with a foreign country of origin.

NMB and NHBB labels that show no country of origin or domestic origin. Boxes, tubes or packages that do not show any country of origin. Labels showing domestic or no country of origin.

and as I am satisfied that there is probable cause to believe that the property so described is being concealed on the person or premises above-described and the grounds for application for issuance of the search warrant exist as stated in the supporting affidavit(s).

YOU ARE HEREBY COMMANDED to search on or before ten (10) days (not to exceed 10 days) the person or place named above for the property specified, serving this warrant and making the search (in the daytime — 6:00 A.M. to 10:00 P.M.) (at any time in the day or night)* and if the property be found there to seize it, leaving a copy of this warrant and receipt for the property taken, and prepare a written inventory of the property seized and promptly return this warrant to the duty U.S. Magistrate as required by law.

U.S. Judge or Magistrate

NAME OF AFFIANT	SIGNATURE OF JUDGE** OR US MAGISTRATE	DATE/TIME ISSUED
William Dean William Dean, Special Agent		5-27-88 9:52 am

*If a search is to be authorized "at any time in the day or night" pursuant to Federal Rules of Criminal Procedure Rule 41(c), show reasonable cause therefor.

**United States Judge or Judge of a State Court of Record.

RJH

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE

No. 0082439

CUSTODY RECEIPT FOR RETAINED OR SEIZED PROPERTY

5234 P&PM

Page 1 of 7

1. DISTRICT - PORT: 2704
2. SEIZURE NO: —
3. GENERAL ORDER NO: —
4. OTHER CONTROL NO: —
5. DATE RET/SEIZED: 6/1/87
TIME OF DAY: 9:00 am
6. RETAINING/SEIZING OFFICER: S/A Wm. Dean
7. TELEPHONE NO: 514 6246
8. NAME & TYPE OF CARRIER: N/A
9. NAME & ADDRESS OF OWNER/CARRIER/CONSIGNEE:
NMB
9730 Independence Av.
Chatsworth, CA
10. EIN/IRS NO: —
11. NO OF PKGS: —
12. APPROX WGT: —
13. ENTRY NO. (WHB, IT, TE, OTHER (DESCRIBE)): —
14. SEAL OR OTHER ID NOS (Bag Tag, B/L, AWG): —
15. IDENTIFYING MARKS PLACED ON SEIZURE: initials
16. SECTION OF LAW VIOLATED OR REASON FOR RETENTION: search warrant
17. IS PROPERTY TO BE HELD AS EVIDENCE? 1 YES - Give Line Item No(s) 2 NO: 1
18. REMARKS (INCL. RECOMMENDED TYPE STORAGE, IF APPLICABLE):
19. DISTRICT DIRECTOR'S ADDRESS: 300 So. Ferry St. rm 2037, Terminal Island, CA 90731

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.*	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST
1.	EMPTY NHBB BOXES	NEW	N/A		2	—	
2.	BLANK "NHBB - MADE IN SINGAPORE" LABELS	NEW	N/A		10	—	
3.	EMPTY NHBB BOXES	NEW	N/A		2	—	
4.	"MADE IN JAPAN" LABELS	NEW	N/A		13		
5.	BLANK "NMB - MADE IN U.S.A" LABELS	NEW	N/A		13	—	
6.	BLANK "NMB - MADE IN CHATSWORTH" LABELS	NEW	N/A		13	—	
7.	EMPTY "NMB CORP. CHATSWORTH" BOXES	NEW	N/A		3	—	
8.	BLANK "NMB MADE IN SINGAPORE" LABELS	NEW	N/A		9	—	
9.	EMPTY NMB BALL BEARING BOXES	NEW	N/A		3	—	

21. ACCEPTANCE/CHAIN OF CUSTODY

a DATE	b BY - INDIVIDUAL, TITLE, ORGANIZATION	c ITEM(S)	d NO OF UNITS	e SIGNATURE
	Signature of Customs Officer			

22. NOTICE OF ABANDONMENT AND ASSENT TO FORFEITURE

I hereby abandon all claim to the above described articles, line item(s) ________, and waive any further rights or proceedings relative to these articles, other than my right to file a petition for administrative relief.

a. Signature of Importer
b. Date
c. Witness (Customs Officer)
d. Date

COPIES: OWNER/CARRIER/CONSIGNEE/VIOLATOR, RETAINING/SEIZING OFFICER, FP&F OFFICER, TRANSPORTATION, OTHER TRANSFERS OF CUSTODY

*For Additional [illegible] CF 6051A

Customs Form 6051 (122085)

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE

CUSTODY RECEIPT FOR RETAINED OR SEIZED PROPERTY

CONTINUATION SHEET

6234 P&PM

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1. DIST - PORT 2704	2 SEIZURE NO.	3 GENERAL ORDER NO	4 OTHER CONTROL NO	5 DATE RET./SEIZED 6/1/88

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
10.	2 LETTERS TO REGIONAL MEMO DATED 1/26/88 & 12/14/87	—	—		2	—	
11.	2 page memo – Price Announcement dated 9/12/87						
12.	12 page memo on Price Adjustment from T. Takahashi						
13	File – Duty Drawback & docs						
14	File – "G. Yamantas" & docs						
15	2 pairs Pricing Sheets						
16	File marked 608 Booking Reports						
17	CIF Price List – dated 6/1/88 P/L Code B (Palmer)						
18	CIF Price List – 6/1/88 P/L Code – A (M & I)						
19	18 page Memo – PTT 7034 from Chairman of Board						
20	Plastic File Holder w/documents marked "Sales Order Backlog (Summary)						
21	12 pages entitled NMB Business Briefs dated April 1988						
22	Statement of Operation dated 4/88						
23	Printout of Sales Commission for NMB						
24	Management Summary Report / April / 1988						
25	File marked JAPAN Order Intake & Sales & docs						
26	File marked "PTT File" & docs						
27	File marked "NHBB Order Intake and Sales" & docs						
28	File marked "NHBB Import Bearings" & docs						
29	File marked "NHBB Domestic Bearings" & docs						
30	File marked "Price Index & How to Handle It"						
31	File marked "Bearing 0000"						
32	File marked "440C & DD" w/ misc docs						
33	2 Inter-Company Newsletters dated May & January of 1988						
34	5 page FAX to Ishikawa dated 5/31/88 from Chicago						

Customs Form 6051A (121685)

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20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
35	10 "Sales & Order Summary Reports"						
36	24 pages FAXES on Bearing Prices (Japanese Script)						
37	File marked KZW w/docs						
38	File marked "Manager's Meeting" & docs						
39	Blue folder containing file marked "NHBB Inventory"						
40	File marked "Bearings & Summary Report" & docs						
41	Green File folder unmarked containing a folder marked						
	"608 Booking Detail Report"						
42	Copies of PO's of shields for Chatsworth						
43	Copy of Teletype PTT 7088						
44	11 "Importation Files"						
	marked as 1) P73-1005873-8						
	2) P73-1005894-4						
	3) P73-1005895-1						
	4) P73-1002703-0						
	5) P73-1002706-3						
	6) P73-1002711-3						
	7) P73-1002712-1						
	8) P73-1002715-4						
	9) P73-1002719-6						
	10) P73-1002720-4						
	11) P73-1002721-2						
45	File marked "Jerry Calvin" & docs						
46	File Folder marked "Pricing Info" & docs						
	(MOB 6-1-88)						

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1. DIST. – PORT 2704	2. SEIZURE NO. —	3. GENERAL ORDER NO. —	4. OTHER CONTROL NO. —	5. DATE RET./SEIZED 1 JUN 88

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
47	Contract files for following contracts:						
	DLA500-87-MY546						
	DLA500-87M-4133						
	DLA500-87-M-Y936						
	DLA500-87-M-U953						
	DLA500-87-M-Y059						
	DLA500-87-M-Y005						
48	DLA500-86-W-0199						
	DLA500-86-W-0064						
	DLA-86-W-0072						
	DLA 500-86-W-0030						
	DLA500-86-W-0217						
49	DLA-86-M-6775						
	DLA500-86-W-0084						
	DLA 500-86-M-KF04						
	DLA 500-86-M-DA04						
	DLA 500-86-C-0030						
50	DLA 500-87-3664						
	DLA 500-87-3280						
	DLA 500-87-V-4919						
	DLA 500-87-M-G524						
	DLA 500-87-M-FG65						
51	DLA 500-85-C-2424						
	DLA 500-85-M-1510						
	DLA 500-85-M-1485						
	DLA 500-85-M-2485						
	DLA ·85-M-F075						
	DLA 500-85-M-GV40						
	DLA 500-85-M-HJ11						
	DLA 500-85-M-HJ27						
	DLA 500-85-M-P211						
	DLA 500-85-M-T001						
52	SHOP ORDERS: SO A5Y602;						
	A5Y650; A74640						
	A74658; A74657						
	A72626; A50601						
	A60051; A60646						
	A76016; A73643						
	A77651; A73626						
	A73626-A; A73626						
	A77605; A7X689						
	A79623; A79650						
	A75636-A; A75636						
	A75635; A75629						
	A51609; A50604	SA M. [illegible] NCIS					
	A50604-1; A44602						

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1. DIST. - PORT 2704	2. SEIZURE NO.	3. GENERAL ORDER NO.	4. OTHER CONTROL NO.	5. DATE RET./SEIZED

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
53	Shop orders: A-A56623-A / A56623						
	A56623/ A56628-A A59629/ A59629-A						
	A59635/ A59630 A60110 / A64617-A						
	A67KD4 A69615 A69104/ A64640 / A63609						
	A-A623/A5X624/A5X627-A A64801 / A60671 / A4X675						
	42611/ A4 2611 / A59632 A5V633 / A5Y633						
54	CONTRACT FILES: DLA500-[illegible]-0100 ([illegible] 91675-02)						
	DLA500-86-M-KE64, (98560-02) DLA500-86-M-[illegible] ([illegible])						
	DLA500-86M-6775 (99635-02) DLA500-86M-[illegible] (97250-02)						
	DLA500-86-M-KF04 (98545-01) DLA500-86M-DN04 (99184-01)						
	DLA500-87W-3664 (99787-02) DLA500-87W-3280 (99121-01)						
	DLA500-87V-H119 (96247-01)						
55	Shop orders: A54618-A						
	A54618-A ; A54116 ; A54616-1 A54609-A ; A36629 ; A51609-A;						
	A51609-B; 4437; A49615-A A49615 ; A43110; A43110-1						
	A40148 ; A44606 ; A44606-1 A3X622 ; A3X652-1 ; A3X652-1A						
	A3X652-1; A3X652-1A; A3X652 A3X648 ; A3X648-1.						
56	CONTRACT FILES: DLA500-87M-4524 (96835-01)						
	DLA500-87M-FD65 (97348-03) DLA500-87M-V005 (99120-02)						
	DLA500-87M-V953 (99678-01) 500 DLA 87M-V936 (99755-01)						
	DLA500-87M-4133 (99560-01) DLA500-87M-V536 (99727-01)						
	DLA-500-86W-0030 (97952-01) DLA500-86C-0030 (97952-01)						
57	DLA500-85-M-HJ27/97789-01 DLA500-85-C-3424/96963-01						
	DLA500-85-M-0488/96236-01 DLA500-85-M-1455/99534-01	SA M. [illegible] DCK					
	DLA500-85-M-1510/99538-02. DLA500-86-M-E075/96170-01						
	DLA500-85-M-6V40/97588-01 DLA500-85-M-H511/97755-01	#57 inventory continued					

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2704				

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
57	Continued DLA500-85-M-P211/96292-01						
	DLA500-85-M-T001/96801-01						
58	Shop Orders: A46606-1; A46106; A46106; A40639 A48610; A48610-1; A3Y618; A3Y618-B						
	A3Y618-1; A3X662; A3X662-1; A3X651; A3X651-1; A51123;						
	A3X620; A57626; A57626-1; A37638; 5744; A55629;						
	A54613; A54613; A54618; A54618-1						
59	Shop orders: A57635, A53608, A53609						

K. Cowan, DCS

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2704 LA				6/1/28

20. PROPERTY (By Line Item) Attach CF 58 if conveyance.

a LINE ITEM NO.	b DESCRIPTION	c CONDITION	d TYPE OF CONTAINER	e U/M	f QTY	g APPRAISED DOMESTIC VALUE	h HELD BY DIST.
60	12 sheets Minebea & Pelmec Industries Invoices Mar 88						
61	4 sheets Minebea Co. Ltd Invoices JAN. 88						
62	5 sheets Minebea Co. Ltd Invoices Nov. 1987						
63	17 sheets Minebea Co. & Pelmec Invoices - Oct. 1987						
64	17 Manufacturing Order Sales Computer Printouts						
65	stack of production reports						
66	folder marked "memo Takahashi"						
67	Printout "USA master price list"						
68	3 folders purchases of ball bearing steel						
69	computer tape + data for tape						
70	printout of employees						

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Senator WEICKER. Now, Commissioner von Raab, what initiated the U.S. Customs investigation of the Minebea Corp. and its two subsidiaries, Nippon Miniature Bearing and New Hampshire Ball Bearing.

Mr. VON RAAB. Senator D'Amato actually notified me of this problem as a result of hearings held before him in a field hearing which I believe was held in New York. Having received that information, we immediately put our agents to work on it, and referred the testimony that had been given before the committee to the agents, and that is how our investigation began.

Senator WEICKER. What led the service to obtain a search warrant against New Hampshire Ball Bearing's California manufacturing facility?

Ms. ALTENSTADTER. If I may answer the question——

Senator WEICKER. If I may add, any member of the panel, whatever you deem appropriate, Commissioner.

Ms. ALTENSTADTER. Basically the investigation developed. It developed information within the industry that led to the search warrant. Special agent Dean.

Mr. DEAN. The initial investigation was to get a preliminary finding as to whether or not the allegations were true and in doing that, I also developed probable cause when it became apparent that this was something that needed to be investigated further. I had some testing done. I talked to some experts, wrote an affidavit for the search warrant, and we served it June 1 of this year in Chatsworth, CA.

Senator WEICKER. I think we have submitted the warrant and the accompanying affidavit. I am not going to go over all the reasons in the affidavit, but I think it is pretty clearly set forth as to why a warrant was obtained, and that will be part of the record.[1]

What have the documents and information obtained from this search of the California plant revealed?

Mr. VON RAAB. They certainly have revealed that there are bases for us to proceed, to continue this investigation because thus far we have been unable to certainly disprove the allegations, so we are proceeding with our investigation. They have given us a basis upon which we will continue to investigate this case.

Senator WEICKER. What are the specific allegations being considered in the Minebea investigation?

Ms. ALTENSTADTER. The specific allegations are the violations of Title 18 U.S. Code 545. Now, that is a general smuggling statute. Normally it would be 542 which is fraudulent statements. However, in the 9th Circuit we received past decisions, and we are going with the smuggling statute. The other statute is giving false statements to a Government officer, and that 18 USC 1001. They are both criminal statutes. We are going for criminal and civil violations here.

Senator WEICKER. What other agencies are cooperating with your investigation?

Ms. ALTENSTADTER. That is the Defense Criminal Investigative Service.

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[1] Affidavit referred to on page 84.

Senator WEICKER. Is Customs aware that the Commerce Department is conducting an investigation of companies from nine countries that allegedly are dumping bearings into the U.S. markets?

Ms. ALTENSTADTER. Yes, we are.

Senator WEICKER. What efforts has Customs made in making the Minebea investigation information available to the Commerce Department?

Mr. VON RAAB. We contacted the Commerce Department and informed them that we had information that we thought would be useful to them in conducting their antidumping investigations.

Senator WEICKER. What was their response?

Mr. VON RAAB. Initially their response was one of some confusion of whether or not they could take these documents. After some discussion, I guess we have successfully gotten them to take the documents from us. So, the Commerce Department now has the documents that we felt would be useful to them in their investigations.

Senator WEICKER. Senator D'Amato.

Senator D'AMATO. Thank you. First, let me commend Mr. von Raab, the Customs people, the special agents and all those that have been involved. They have done, I think, a terrific job in following up on complaints that have been made by those who are out there, who know what's going on, who see laws being broken with regularity, and who finally in desperation came to the Congress to see if something could be done. I am confident that the truth will come out, and that is what we want.

Now, Commissioner, you have indicated in your prepared statement that currently there are nine active investigations with allegations involving false statements to evade antidumping measures so far in fiscal year 1988. You say you have spent 6,000 investigative hours in this area. Are these investigations a result of ordinary customs enforcement efforts or are they keyed to a specific strategy?

Mr. VON RAAB. I would like special agent Altenstadter to answer that question.

Ms. ALTENSTADTER. We do have ongoing programs in the steel area which is notorious for having dumping violations, allegations made, and we do have cases involving other commodities other than steel, and we do have a multidisciplined commercial fraud center at headquarters that is trying to monitor these cases and to support the field.

Mr. VON RAAB. For example, we are developing some effect software to use on our customs data base which all the data on all the shipments coming into the United States. On the basis of this special sort of computer program that we are developing, we expect to kick out a number of cases because the data that does come in often indicates—if you can deal with it in a sophisticated enough manner—where there are dumping problems. This is part of a general program to look for these kinds of problems.

Senator D'AMATO. To pursue one of the questions that Senator Weicker raised regarding the specific allegations being considered in the Minebea investigation, you indicated one of them was related to the U.S. code provision on smuggling, is that right? Could you be more specific? What do we mean by smuggling? That is the general term that I think they used.

Ms. ALTENSTADTER. We have our counsel here. He may be able to help on this.

In the 9th Circuit we received a decision that smuggling is entry of goods without any statement. In other words, goods not manifested when they come in or not declared upon entrance into the United States.

Senator D'AMATO. Should there have been a declaration or manifest as it related to these goods under the law?

Ms. ALTENSTADTER. Yes, there was, and normally in the other circuits we would have used title 542—I mean title 18, section 542, which is entry by fraudulent statements on the entry itself. But in the 9th Circuit we have a unique situation, so we use the smuggling statute.

Mr. VON RAAB. I can explain the three statutes. This is an interesting situation. Section 542 basically applies to the filing of false entry documents, in other words, our prescribed documents with the Customs Service. It basically means you use false documents through Customs. That is what smuggling fraud means. That is why we use 542.

Senator D'AMATO. What kind of thing would we be looking for and what is it? What are they being accused of?

Mr. VON RAAB. They would have been accused of misclassifying or misdescribing, in this case the ball bearings as lower graded ball bearings as opposed to what they may have been, which would have been higher graded ball bearings. The obvious purpose there is clear. The obvious purpose is to get these bearings in, to pay less duty, and to avoid the dumping provisions, thereby escaping the protections that our laws are supposed to provide.

Senator D'AMATO. In other words, if I bring in a product which is less sophisticated or is not as precise, a lower quality, by that I escape the various requirements?

Mr. VON RAAB. You pay less duty because you lied about what it was worth. On the other hand, you escape dumping because you told them it was lower valued, and therefore you do not catch them bringing in high-value goods.

Senator D'AMATO. At a lower price?

Mr. VON RAAB. Right.

Senator D'AMATO. I am not saying that is the case, but that is what you look for?

Mr. VON RAAB. That is right.

Senator D'AMATO. Now, you mentioned another section of the law misleading statements. There was a second section. What was that?

Mr. VON RAAB. There is section 1001, which is basically lying to a Federal officer. That is what it is. If you come to Customs and you lie to a Customs officer and you are found guilty, you are violating a criminal law. That is what we are talking about here. So, if you lie about what you are bringing in, in terms of the quality of imported ball bearings, you are lying to a federal officer, and it is a criminal violation.

Senator D'AMATO. Have there been any allegations of false labeling as it relates to the place of origin of bearings or statements that would lead one to believe the bearings that were being manufactured abroad were being sold as being manufactured within this country? Has your investigation covered any of those areas?

Mr. von Raab. That is really the investigation that the Defense Criminal Investigative Service is handling. And if we come across anything like that, we give them the information that we may have developed. That is really the case—it is the 440 case, as we call it.

Senator D'Amato. Do you have any estimate of the time it will take you to complete your investigation? Are you fairly well through with it? If you could give us a sense of time——

Mr. von Raab. We would hope to be finished with this by the middle of next year. It is very complicated, obviously. It involves lots of paperwork, lots of entries, and it is a very sophisticated scheme. We have to make doubly certain that we are very careful in the way we investigate this.

Senator D'Amato. I have no further questions, Mr. Chairman. Again, I want to commend the Service for undertaking this investigation and for the thoroughness with which they are approaching this. Certainly, if it turns out that some of the allegations that have been raised are true, I hope that there would be an appropriate response through our justice system to this kind of behavior.

Again, if those allegations are proven to be true, it would be outrageous. Remedial action certainly would be necessary. I do not know how you compensate for the loss of all of those American jobs. If this is proven to be an ongoing pattern, and I would not be a bit surprised if that were the case, we must respond. I will look at the appropriateness of the response if there is a final judgment that things have taken place that have been alleged. We must respond strongly if false and misleading statements, dumping, or other acts are proven, violating with regularity the laws designed to provide fairness and also to protect our national security.

Mr. von Raab. If I might comment on that one point, Senator, the U.S. Attorney in Los Angeles, Mr. Bonner, has been working very closely with us and very enthusiastically in that respect. The Justice Department is doing a very good job, so that is working very well.

Senator Weicker. I have to confess that I am not wildly enthusiastic, although you understand better than I since you have a better grasp of the facts.

The resolution of the investigation the middle of next year, that is a fair time span and then knowing what the bureaucracy does with the results, it will probably be another year after that.

Mr. von Raab. There are several investigations. There will be the dumping investigations. The Customs Service is doing the customs violation investigation, and the DCIS, Criminal Investigative Service is doing theirs. If that is a concern to this Committee, we will certainly look into the possibility of expediting it.

Senator Weicker. We do not want you to expedite it to the point where you jeopardize your case, but I will say this. As you well know, since you made the request as to the U.S. Attorney, this Committee is in the possession of many of the documents that are a key to this case and we are not putting them on the record, and we are not going to raise them, and we are not going to talk about them today, but we have got them, and somewhere along the line if we see the bureaucracy is stumbling around out there, we are going to have another hearing. And I am no longer going to live by the guidelines, if you will.

Mr. VON RAAB. I will make this commitment to this Committee: I will review the personnel that have been committed to this case and if increase of resources to this case can move this along more quickly, we will do it.

As you are well aware, sometimes constraints on a case are not resource, but they are court decisions, motions, appeals, and so forth. But I will look into it and find out how quickly we can make it move, and I will assure you that we will do that.

Senator WEICKER. I think the investigation work done by special agent Dean has been right on the mark. He is doing his job, but I suppose we are a little leery, not of the work that Customs is doing, but when the President deferred 232 action, it sort of got us in the light of what we thought were pretty obvious facts.

Now, as I understand it, he has to make a decision by November 21. I just do not want to see this thing slip by any further. And your assurances are quite satisfactory to the Committee.

Mr. VON RAAB. I have a telephone. If I am concerned, I will call Bonner and tell him two very powerful, important Republican Senators are worried about this case. If we can move it up, we will.

Senator WEICKER. I have one more question to Mr. Dean. In paragraph 23 of the affidavit—this is a matter of public record—in paragraph 23, "Based on my investigation, which is summarized in this affidavit, I believe the following: NMB claims more production than it actually performs so that it can sell imported foreign ball bearings as a domestic product. For example, the Chatsworth plant makes 300,000 units a month. Another 300,000 foreign bearings a month are sold as domestic to match the 'announced production rate' of 600,000 units. The above described acts would constitute both Customs and DCIS violations. I believe that NMB production, import and sales records will prove these violations and want to search for these documents at the Chatsworth facility. I.S. Sawelenko, CI 1 and CI 2 have told me these records are kept on computer tapes."

Is there anything you would like elaborate on as far as your belief at the time that you wrote this affidavit?

Mr. DEAN. My belief has not changed. We have copies of the computer tapes that we got during the service of the search warrant. The printouts have been run, but the accounting totals are not yet arrived at.

Senator WEICKER. Unless Senator D'Amato has further questions, I thank you all for your courtesy and for your assurances and hopefully we will get to the bottom of this matter one way or the other, and I am sure that will be the case. Thank you very, very much.

Our next witness is Mr. Donald K. Brush, who is the vice president and general manager of the Bearing Product Operation of The Barden Corporation, Danbury, CT, and Mr. Augustine Sperrazza, chairman and chief executive officer of PacAmOr Bearings, Troy, NY.

Why do we not proceed in the order that I announced the witnesses.

Mr. Brush, it is nice to have you here. All statements of witnesses will be placed in their entirety in the record. And I think it would be helpful to the Committee if you could summarize your statements so that we could have more time to go back and forth because this is an education process, believe me, and I think we can do a better job if we have the opportunity to go back and forth, so please proceed with your statement. It will be put in the record in its entirety. You can proceed any way you deem fit.

STATEMENT OF DONALD K. BRUSH, VICE PRESIDENT AND GENERAL MANAGER, BEARING PRODUCT OPERATIONS, THE BARDEN CORP., DANBURY, CT

Mr. Brush. Thank you for offering me the opportunity to share my thoughts with you today. Briefly let me tell you what The Barden Corp is, who we are, what we do, what our product line is.

Barden is generally recognized throughout the world today as a leading supplier of super precision ball bearings 5/32 inch in diameter up to about 11 inches in diameter. We have two bearing plants, one located in Connecticut in Danbury, one in Plymouth, England, a plant that makes balls in Winsted, CT, and another plant in Bridgeport, CT that makes some stampings, but they also make things other than products for ball bearings. The company's sales for 1988 will exceed $80 million. We have about 1,450 people. So that is a quick wrap-up as to what we are.

For reasons of clarity, our ball bearing product line can be broken down into three categories: so-called miniature and instrument bearings, which is what we have been talking about here primarily—this is with the Customs people, 0–30 millimeter outside diameter. These bearings are used in aircraft, space navigation, other flight control instruments, synchros, servos, dental hand pieces, X-ray tube bearings. I have, incidentally, some samples up there which I will be glad to answer questions about later.

The next size range is 30–100 millimeter, so-called spindle and turbine bearings used in machine tools, aircraft accessories such as starters, blowers, auxiliary power units and generators and so forth. And, incidentally, the DOD is a customer of ours in about the same proportions of the industry as a whole, about 15 to 20 percent of our business is for DOD applications, either direct or indirectly through OEM.

The last size range is over 100 millimeter, which includes aircraft engine and the so-called "noise quiet" bearings for submarines. Representative Johnson mentioned this earlier in her testimony, and Barden is the only U.S. producer of that entire line of "noise quiet" bearings for submarines. There are several other suppliers, but they don't supply the whole line.

In all, Barden has a customer base of over 1,000 companies, and we manufacture about 2½ million bearings a year. All of these are so-called super precision. And I want to dwell on that because I've been asked the question, what is the difference between a commercial bearing and a precision bearing and a super precision bearing. Super precision or the degree of precision in a bearing is determined by a method set up through the Anti-Friction Bearing Manufacturers Association, and they are graded into grades 1, 3, 5, 7, and 9, the most precise being 9. Barden only produces 7's and 9's.

The tolerances used and required to be met in making super precision bearings are often described in terms of a millionth of an inch. And to demonstrate that to you what a millionth of an inch is, that is about 4 inches long. If that is a steel rod 4 inches long, and I hold it that way and then I hold it that way, it is one millionth of an inch longer that way than it is that way because the weight of the rod is stretching it one millionth of an inch.

Put it another way. If the thickness of a dime were a millionth of an inch, three times the height of the Empire State Building would be one inch. It takes a million dimes stacked on top of each other to equal three Empire State Buildings. And we are measuring—I might say trying to measure many times—to tolerances of even less than a millionth of an inch.

The reason for this and the need for this is in super precise rotation and super low noise. Any disparity in a bearing that is used in a gyro—and you are shooting something, let us say, to the Moon—it causes a gyro not to operate correctly, it will "precess" is the correct technical term, and you are going to miss the Moon. So, clearly you want to make it as precise as you possibly can.

The same thing is true, of course, in submarine bearings where noise is extremely important.

Now, in making a super precision bearing, essentially the process is identical to making a less precise bearing. The same machinery is used. The same machine tool builders in this country that make our machinery make machinery for bearings that are less precise. The difference is that the cycle times, that the amount of time that you are grinding a raceway that the ball rolls in will tend to be longer because you are leaving it in there to make sure that you got out all the little bumps. There is more attention time from the operator. That means that an operator cannot run five or six machines. The operator can run maybe only one machine because they are constantly checking to see if the machine is drifting.

There are many in-process and post-process inspections which can't be measured either at or on the machine. And, of course, the assembly of super precision bearings requires skilled personnel, and usually these lot sizes are very small so that you cannot automate it. So, it is expensive. So much for ball bearings, per se.

History of Barden. Very quickly, Barden was started in 1942 to make the bearings for the Norden Bomb Site. It was formed by Carl Norden, the inventor of the bomb site and a man named Theodore Barth, thus the name Barden. And the reason it was formed is nobody could consistently make the bearings that were required for the bombsite.

Barden started as a sorting house. Other people were making bearings that were shipped to Barden. They were inspected, the bad ones were thrown out and the good ones were used. Then Barden went into the business of making them good the first time.

After the war—this was done, incidentally, under the auspices of the Navy with a lot of Government money—it became a private company that grew and prospered and with the Vietnam war requirements, we got up to a production rate of 5½ million miniature and instrument units a year. That was in 1966. That was the highest level of production that we had ever seen at that time, and it is the highest we have ever seen since then.

And about this time when the war effort started to recede, this is when the foreign competition, primarily from Japan, started to absorb a larger and larger share of the ball bearing market.

I want to point out that the noteworthy features of this competition were that it was concentrated in the high volume end of the business. The quality was excellent. And prices were always low enough to get the order. Always. In fact, we had a sales arrangement with NMB for several years. And this was back in the late sixties, perhaps early seventies, when the man who is currently our director of marketing was a young sales engineer, and he attended a meeting in which Mr. Takahachi, the chief executive officer, told our sales engineers as well as his sales engineers, "You will continue to reduce the price by 7 percent until you get the order." And when he was asked the question what about cost, he said, "That is my problem. You get the order."

There is no way we could compete with that. We have stockholders to whom we have to answer. We do have a cost. We have to get a price which is higher than our cost, and so we had to rethink our business. Fortunately we had already been starting to build larger bearings over 30 millimeters in diameter. We had started that in the sixties, and so we started to "grow" that business.

As we look back over the last 20 years or so, it is evident that the specialty, high-reliability ball bearing business has grown. But additional foreign competition, principally from West Germany, France, Italy, Singapore, and Thailand has captured a greater market share. As a result, the Barden Corp. has stood still for 20 years. The demands in the market have grown, but we have not grown. I'm proud to say we haven't shrunk, either, and the reason for that is that we were in a constant state of change in order to continue to find new niche businesses, new places where we could go to avoid predatory pricing.

This required changes in our production facilities, rather substantial changes in our production facilities. As we were building larger bearings, we had to make significant capital expenditures for new machinery and material handling equipment, new measuring equipment, and actually add floor space because these bearings were larger and they took up more room. And as I said in my written testimony, for a business that hasn't grown, these expenditures represented a sacrifice in earnings in order to survive.

Now, we are having to do the same thing again because for many years the ball bearing industry—well, the ball bearing industry is a mature industry, and by that it is generally meant that new things do not come along very often. And that was true for many years in the manufacture of ball bearings. There was not much new in the way of technology.

The computer has changed all of that. There is now a whole new round of modernization going on with computerized turning machines, grinding machines, measuring machines. So, we are back at it again and making very substantial capital expenditures in order to continue to compete. But for all of this, I mean if your instrument business has dropped from 5½ million bearings in 1966 to 1.1 million bearings this year, that is a drop of 80 percent.

We have increased our large bearing business from 350,000 to about 700,000 bearings a year. Employment has dropped sharply. We have about 800 people now, about 60—this is in the Danbury plant—about 60 percent of job losses have been due to reduced activity and 40 percent to improved productivity. Currently, we are running at about 80 percent of our capacity for miniature and instrument bearings. We have obviously shed off capacity because it wasn't needed, and we are running at 95 percent capacity in larger bearings.

OK. So, what conclusions can you reach about all of this for the bearing industry as a whole? Clearly the high volume producers with dedicated automated lines, which we do not have, have been hurt the most by foreign competition. Some of them have actually gone out of business as has been mentioned today, some have moved south. Fafnir just moved a plant south that I am aware of. Published data indicate many companies are trying to modernize their plants, but profits have been shrunk. They are not able to modernize at the rate that they should, and what has happened is that no strategy seems to have been successful and indeed, the U.S. bearing industry is smaller today than it was 20 years ago, and the charts show that here.

I asked the question what is the net effect of all of this. Clearly some people will tell you that the American consumer has apparently benefited, at least in the short term, from lower cost, high quality bearing imports. Let's just say all right, that is a fact. I think also intense foreign competition has forced U.S. bearing manufacturers to rethink their business and cut their costs dramatically, and they are more efficient. If those were the only considerations, then you might conclude well, just leave it alone. Let the survival of the fittest, laissez-faire, and so forth, take its course.

But I think there are other considerations which have been mentioned here today, and I will just repeat them. Certainly the need for fair trade and certainly the need for national defense, and I would throw another one in there as I am beginning to have my doubts about free trade, at least as it applies to the manufacturing base in this country.

American bearing manufacturers, as opposed to many foreign manufacturers, are not subsidized by Government nor are they targeted by Government for special help in export markets nor are they allowed to rationalize their product lines to promote efficiencies such as in Germany. They are helped by antidumping laws and Federal acquisition regulations, but these have not been administered.

The degree of dumping and its effect on the bearing industry, if not critical, is surely obvious, illegal, and should be dealt with. But in my opinion, of far greater importance is the need for a viable bearing industry to support the needs of the national defense.

And in regards to free trade, I am not an economist, but I have read many times and understand that our manufacturing base creates a hell of a lot of more wealth than our service industries. If we allow our manufacturing base to deteriorate, we will become a less wealthy Nation. All you have to do is go to Austria and get a hotel room. Go to Japan and get a hotel room, and you are going to feel poor. Our standard of living is slipping.

Now, what can be done and should be done, and I would like to read directly from my testimony on this. The recent Federal acquisition regulation takes a step in the direction of helping the industry catch its breath, modernize and become more competitive. But a number of questions still remain. How effective can the FAR be when it only protects 15–20 percent of bearing production? How does U.S. business compete with the low wages and other costs of Singapore and Thailand? No amount of modernization could reduce costs to compete with labor rates that are 1/19 of ours.

Incidentally, I do not think this is any secret to anybody in the ball bearing industry, but about 60 percent of our costs are people and people-related costs in making a ball bearing. When you are competing with labor rates that are 1/19 of yours and with no social costs that are associated with that, you cannot do it. And no amount of modernization is going to make up for that.

Will the domestic bearing industry have sufficient capital to adequately modernize and meet foreign competition from Japan, Germany, France, Italy, and other countries. I wonder. Will the FAR encourage foreign bearing manufacturers to build in the United States? If so, will they be full production plants or, for example, only an assembly operation which wouldn't satisfy the FAR requirements but would capture market share without effectively adding to the industrial base.

The real trick in making a super precision ball bearing is not in the assembly of the parts. It is in the making of the parts. So, if you are just an assembly operation, I could set up an assembly operation tomorrow.

Will the U.S. Government vigorously administer existing regulations designed to promote fair trade? If it does not, then why should we spend millions or perhaps billions to modernize, only to find that imports are still driving the industry out of business. Put another way, what faith should the industry put in the U.S. Government during and after the time period covered by the FAR?

My personal view is that the new Federal acquisition regulations which extends the requirements to all sized bearings will, at best, only slow down the inevitable. I don't think the American bearing industry will wither away, but it will continue to shrink and what is left will probably be quite competitive in tiny, little niche markets. But it will not support military needs in a national emergency.

Just take the Vietnam war. Barden sold 5½ million miniature and instrument bearings. We have the capacity today to make a million three hundred thousand. If we got into another confrontation, I do not know what the multiplier is on a million three, but obviously we cannot respond to that.

For this reason, my company joined with others in a petition under section 232 of the Trade Expansion Act of 1962. It seems to us that only by the restriction of imports from all bearing uses can we ensure an adequate industrial base which includes modern plant equipment and trained personnel. If the proposed remedies are imposed, then the questions I raised about the new FAR are largely moot, and the U.S. bearing industry will be given a reasonable chance to plan ahead with confidence, modernize and become more competitive. We will also be preserving and indeed enhancing the standard of living of those not only in the bearing industry, but also those who serve the industry.

Those are my remarks. I would like to make it a matter of record that we are most appreciative of the work that has been done by the Bearing Caucus, in general, by Representative Nancy Johnson in particular, and again, I appreciate the opportunity to share my thoughts with you today.

[The prepared statement of Mr. Brush follows:]

TESTIMONY PREPARED FOR PRESENTATION TO THE UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS

SEPTEMBER 8, 1988

My name is Donald K. Brush and I am Vice President and General Manager of Bearing Product Operations for The Barden Corporation of Danbury, Connecticut.

I wish to thank the members of the Senate Committee on Small Business for inviting me to present my views on the plight of the U.S. ball bearing industry. Before I do that, it might be well to briefly describe my company and its product.

The Barden Corporation is generally recognized throughout the world as a leading supplier of super precision ball bearings in the size range 5/32 to 11 inches, outside diameter. The company is integrated both horizontally and vertically and owns two plants which produce bearing components as well as two which manufacture bearing parts and assemblies. Three of the four facilities are located in Connecticut and the fourth is in Plymouth, England. About 20% of Barden's manufacturing capacity is devoted to products other than ball bearings such as linear bearings, surgical devices, precision stampings and balls for other than bearing use. This productive capability is supported by a system of sales offices and agents throughout the world. Total corporate sales in 1987 were in excess of $78,000,000 and will exceed $80,000,000 in 1988. Employment stands at about 1450 people.

1. Miniature & Instrument Bearings (0-30 millimeter outside diameter)

These bearings are used in aircraft, space navigation and other flight control instruments, synchros, servos, dental handpieces, X-ray tube bearings, tape recorders and computer peripheral equipment such as carriage and way bearings. Principal customers include Sperry Marine, Litton, Bendix, Honeywell, Castleberry as well as the DOD.

2. Spindle & Turbine Bearings (30-100 millimeter outside diameter)

Machine tools, aircraft accessories such as starters, blowers, auxiliary power units and generators, synthetic textile winders, high speed vacuum pumps, centrifuges and computer peripherials such as memory drums and disc spindles are typical applications for this size range. AirResearch, Barmag, Hamilton Standard, Hewlett Packard, Bryant, Cincinnati Milacron, Whitnon and the DOD are important customers for these products.

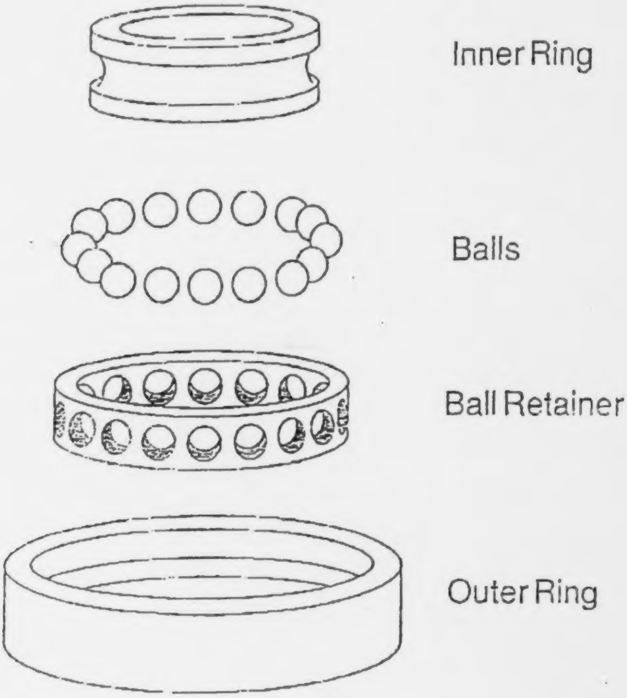
3. Aircraft Engine and Large Spindle & Turbine Bearings (over 100 millimeter outside diameter)

This size range is represented in aircraft gas turbine applications, "noise quiet" submarine machinery and large machine tools. Garrett, Allison, General Electric, Cincinnati Milacron, New Britain Machine, Hardinge and the DOD are key customers for these bearings.

In all, Barden has a customer base of over 1000 companies and manufactures approximately 2,500,000 super precision bearings per year.

Before proceeding with a discussion of the ball bearing industry in general and Barden in particular, it might be well to define briefly what is a ball bearing, how is it manufactured, what is super precision and how is it achieved in the manufacture of ball bearings.

A ball bearing has four major components - an outer ring, an inner ring, balls and a ball retainer. (See Figure).



The manufacture of a typical super precision ball bearing requires approximately 40 manufacturing operations including turning, hardening, grinding, honing and numerous assembly operations as well as dozens of inspections. The machinery and inspection equipment used is sophisticated and expensive. For example, a typical grinding machine for parts 1 to 3-1/2" in diameter costs about $400,000 and a device to measure the roundness of a part might cost $75,000. We estimate that to replace our machinery, equipment and tooling would require $100,000,000 and that expenditure would produce only 3,000,000 super precision bearings per year.

The difference between precision and super precision is defined by the tolerances that must be held on the various part parameters. The industry uses a system devised by the Annular Bearing Engineers Committee, an arm of the Anit-Friction Bearing Manufacturers Association. Bearings are graded into five categories called ABEC 1, 3, 5, 7 or 9 with the last two being considered super precision. ABEC 1 bearings conversely are the least precise and are considered commercial grade.

Many tolerances for super precision bearings are expressed in millionths of an inch which requires know how, care and cost to make and measure. In fact, if one ignores the cosmetic differences, it is impossible to distinguish between precision and super precision grades of bearings except by sophisticated measurement.

The process to make super precision bearings is essentially identical to making a less precise bearing. The same equipment is used but the cycle time, or time to complete an operation on a machine, is often longer and each machine requires more attention time from the operator to assure that the tighter tolerances are being held. In addition, in-process and post process inspections are required which cannot be measured either at or on the machine. Finally, the assembly of super precision bearings requires skilled personnel to perform precise hand operations which are difficult or impractical to automate because volumes are low. All this means more equipment and people and thus higher cost for super precision as opposed to a less precise product.

Although Barden is in a "niche" business, specializing in super precision bearings for use in difficult applications, it is instructive to review the company's evolution when examining the ball bearing industry as a whole. Of particular interest is the last twenty years or so when significant changes have occurred in the market place requiring a major response on the production line.

Barden was founded in 1942 to produce the bearings used in the Norden bombsight. Prior to this there was no capability in this country or in the world, for that matter, to consistently produce ball bearings which met the precise rotational and low torque requirements of the bombsight. Barden was formed to meet this need, which it did, and then, after the war, this capability was applied to many other demanding applications such as inertial guidance systems and synchro and servo motors. The company grew and prospered for twenty five years integrating horizontally and vertically and adding capacity both here and in England. The Vietnam war requirements put a tremendous strain on production requirements which reached 5,500,000 units in the 0-30 millimeter range in 1966. This was, and still is, the highest level of activity in this size range that the company has ever experienced.

As the war effort started to recede, the demand for bearings decreased, but at about the same time foreign competition, primarily from Japan, started to absorb a larger and larger portion of market share. Noteworthy features of this competition were that 1) it was concentrated in the high volume end of the business, 2) the quality was excellent and 3) prices were always low enough to get the order. The first two features are common enough in a tough competitive environment, but the third had the greatest single impact on Barden's business as well as other domestic producers. There was no way to compete with the strategy of "get the order regardless of price". As a result, we had to rethink our business and start to focus our efforts at lower volume, specialty bearings in the 0-30 millimeter range and expand our capabilities into larger bearing sizes. Fortunately, we had started the latter in the 60's and already had a base to build on. Thus the product mix started to change away from synchro and servo motors and high volume inertial bearings in the miniature and instrument size ranges, and more and more into machine tool, aircraft accessory and, more recently, "noise-quiet" submarine machinery bearings. All of these applications require bearings with very accurate rotational characteristics, low noise levels and low torque - the hallmarks of super precision ball bearings. None of them are high volume products and each has its own special requirements. This is where Barden's strength in engineering was of benefit as the business changed in order to survive.

As we look back twenty years, it is evident that the specialty, high reliability ball bearing business has grown, but additional foreign competition, principally from West Germany, France, Italy, Singapore and Thailand, has captured a greater market share and as a result, Barden has seen little or no real growth in sales or profitability. Also, overseas competition is no longer concentrated in the 0-30 millimeter market but has extended into larger sizes as well. As noted above, however, sustaining the same level of business at Barden has required substantial changes in product mix and productive resources. As one market was lost, another was identified and cultivated. For example, during the 70's and early 80's, Barden entered the computer peripheral market only to be displaced in the last five years or so by imports from Japan and West Germany. On the other hand, Barden now supplies the complete range of "noise-quiet" submarine machinery bearings which were previously made in Japan. This new business was made possible because of a decision by the DOD to develop a domestic source.

In light of the changing market place, production facilities had to change as well. The Barden bearing plant in Danbury, Connecticut was built to produce bearings up to 1" in diameter. Plant layout, material handling and storage areas as well as production equipment were designed for small parts which were easily handled and stored and which required relatively little in the way of electric power to produce. As larger bearings became the norm, significant capital expenditures were committed for new and larger equipment, additional floor space, more power and additions in material handling equipment. For a business that wasn't growing these expenditures represented a sacrifice in earnings in order to survive. Having made those sacrifices once, we are now faced with another round of capital commitments to take advantage of modern technology and stave off foreign competition.

The bearing industry is a mature industry not subject to rapid growth or technological change. For years the equipment used to produce super precision bearings changed little and cost reduction efforts were constant but not especially significant. As computer technology was adapted into machine tool design, and measuring instruments, the opportunity for important changes in processing became available. Foreign and domestic competitors have incorporated these new techniques into their production lines and we must modernize to compete.

But, for all the expansion and purchase of new equipment, capacity has been reduced dramatically for miniature and instrument bearings from 5,500,000 to 1,100,000 bearings per year while increasing from 350,000 to 700,000 bearings per year for larger bearings. Also, employment has dropped sharply. Approximately 60% of job losses have been due to reduced activity and 40% to improved productivity. Today we are operating at the following capacity levels in our domestic bearing plant:

Miniature & Instrument	80%
Spindle & Turbine	95%
Aircraft Engine & Large Spindle & Turbine	95%

Our English plant produces only Miniature & Instrument sizes and is operating at about 2/3's capacity. This capability, of course, is not available for DOD applications.

So much for Barden's history. What conclusions can be reached about the remainder of the bearing industry? It is probably true that the bearing manufacturers who are high volume producers with dedicated/automated lines have been hurt the most by foreign competition. As a whole, these businesses have shrunk and suffered more severely at the bottom line. Some have actually gone out of business; others have moved to areas with lower labor rates. Published data also indicate that many companies are trying to modernize their plants but they are limited by lower profits. The fact remains that no strategy has proven successful, and the U.S. bearing industry is indeed smaller and less profitable than it was twenty years ago. For more detailed information about the problems facing the bearing industry in general, the following reports examine the problem in great detail:

1. "Competitive Assessment of the U.S. Ball and Roller Bearing

Industry" - prepared by the United States International Trade Commission dated January 1986.

2. "Joint Logistics Commanders Bearing Study" dated 18 June 1986.

Finally we come to the ultimate question. What is the net effect of all this? There are several answers to the question:

1. Clearly the American consumer has apparently benefited, at least in the short term, from lower cost, high quality bearing imports.

2. Intense foreign competition has forced U.S. bearing manufacturers to rethink their businesses and cut costs dramatically thus becoming more efficient.

If there were no other considerations, and one is a proponent of the free market, then you might conclude that the correct policy would be to let the market take its course and allow the "survival of the fittest". However, there are other considerations - namely the needs for fair trade and an adequate national defense, both of which have been recognized by the Congress and Administration. In addition, I think the whole policy of free trade needs to be examined realistically simply because it doesn't seem to be working.

American bearing manufacturers, as opposed to many foreign manufacturers, are not subsidized by government, nor are they targeted by government for special help in export markets, nor are they allowed to rationalize their product lines to promote efficiency. They are helped by anti-dumping laws, Federal Aquisition Regulations which prohibit the use of foreign made 0-30 millimeter O.D. bearings in DOD applications and now, recently, with the new FAR which essentially extends the old one to all bearing sizes. The problem is that the anti dumping laws have not been administered nor has the old FAR. Clearly Congress intended to help promote fair trade through anti-dumping regulations and the DOD has recognized the potential threat to the national security by restricting procurement of Miniature & Instrument bearings to domestic producers.

The degree of dumping and its effect on the bearing industry, if not critical, is surely obvious, illegal, and should be dealt with. Of far greater importance is the need for a viable bearing industry to support the needs of national defense. It has been estimated that only 15-20% of all domestic bearing production is for military applications today. I have no idea how many times that would be multiplied in a national emergency (during the Vietnam war the multiplier was 5X's what Barden is currently producing in Miniature & Instrument bearings), but it seems obvious that the industry cannot be allowed to shrink further. Unfortunately, any rational appraisal must conclude that further penetration of foreign imports will continue and as a result, the industry will continue to contract.

Finally, the issue of free trade must be addressed forthrightly. I am not an economist and don't claim to understand the ins and outs of international trade. But I have great difficulty understanding why free trade is so good when I see people losing jobs and our standard of living eroding. No other country in the world with important economic clout espouses free trade probably because they want to protect their domestic markets and their standards of living. The bearing industry is only a representative sample of U.S. manufacturing in general, and if it can't compete neither can other businesses. Manufacturing produces almost twice the wealth for each dollar spent than does the service sector. Clearly we will be a less wealthy nation if we continue to lose our manufacturing base.

What can and should be done? The recent FAR takes a step in the direction of helping the industry catch its breath, modernize and become more competitive. But a number of questions still remain. How effective can the FAR be when it only protects 15-20% of bearing production? How does U.S. business compete with the low wages and other costs of Singapore and Thailand? No amount of modernization could reduce costs to compete with labor rates 1/19th of ours. Will the domestic bearing industry have sufficient capital to adequately modernize and meet foreign competition from Japan, Germany, France, Italy and other countries. I wonder. Will the FAR encourage foreign bearing manufacturers to build in the U.S.? If so, will they be full production plants or, for example, only an assembly operation which wouldn't satisfy the FAR requirements but would capture market share without effectively adding to the industrial base. Will the U.S. government vigorously administer existing regulations designed to promote fair trade? If it doesn't, then why spend millions, perhaps billions, to modernize, only to find that imports are still driving the industry out of business. Put another way, what faith should the industry put in the U.S. government during and after the time period covered by the FAR?

These are nagging questions and my personal view is that the FAR at best will only slow down the inevitable. I don't think the American bearing industry will wither away but it will continue to grow smaller and what is left will probably be competitive. But it won't support military needs in a national emergency and there will be a permanent loss of wealth in this country. For this reason Barden has joined other domestic producers through the auspices of the Anti-Friction Bearing Manufacturers Association in a petition under Section 232 of the Trade Expansion Act of 1962. The petition seeks broad relief from bearing imports by the imposition of quotas ranging from 0% for super precision bearings to 35% for other ball bearings. (The percentages refer to the percent of market share allowed for imports.) Only by the restriction of imports for all bearing uses can we insure an adequate industrial base which includes modern plant, equipment and trained personnel. If the proposed remedies are imposed, then the questions I raised about the new FAR are largely moot and the U.S. bearing industry will be given a reasonable chance to plan ahead with confidence, modernize and become more competitive. We will also be preserving and indeed enhancing the standard of living of those not only in the bearing industry but also those who serve the industry.

Before I conclude my remarks, I would like to thank the members of the Bearing Caucus in general and Representative Nancy Johnson, in particular, for their efforts on behalf of the industry. I also appreciate the Committee members' concern and thank you again for this opportunity to meet with you today.

Responses To Questions By Senator Weicker in Letter To Donald K. Brush, Dated September 13, 1988.

1. Q. Mr. Brush, which foreign manufacturers are your chief competitors?

A. My answer is broken into two parts. First, those foreign manufacturers with whom we compete presently, and I might say, reasonably successfully, are:

FAG

GMN (Geo. Muller, Nurnberg)

SNFA

RMB

SKF

FAFNIR (UK)

RHP

It is also a fact that NMB, through its pricing policies, has effectively cut us out of all but the most specialized Miniature & Instrument Bearing business. Thus we would be competing in this business today if it were not for NMB.

2. Q. What is your reaction to the President's decision to not act upon the 232 National Security petition to protect the bearing industry? What signal will the President send to domestic manufacturers if no action is taken to the 232 petition?

A. I think the President is making a mistake by not acting now. It is my understanding that he wants to see the effect of the new FAR before making a decision. Clearly, the new FAR cannot possibly revive the bearing industry by itself. Military requirements today comprise only 15-20% of current production. Protecting that will help, to be sure, but it won't insure the required base to meet a national emergency which would multiply military requirements many times. Also, it will take many months for the effects of the FAR to become apparent. Little or nothing will be known by November 21st.

Now, I believe that a sudden imposition of import quotas, which would significantly reduce foreign imports, would cause a severe strain and the bearing industry would not be able to respond in a timely manner. This would certainly cause important problems for our economy. But, this can be avoided by a controlled phase in of quotas which the petition specifically recommends.

If the President takes no action on the 232 petition, he will be saying, in effect, that he believes the bearing industry's survival is not at stake and the nation can survive a military crisis with sufficient supplies of bearings. The industry knows otherwise and, with the lack of support from Washington, will be reluctant to make the strategic decisions and take the financial risks to stay abreast of modern technology.

DKB
9/20/88

Senator **Weicker**. Thank you very much.

Mr. Sperrazza, and we will be giving questions to both of you after the presentation.

STATEMENT OF AUGUSTINE J. SPERRAZZA, JR., CHAIRMAN AND CEO, PACAMOR KUBAR BEARINGS, INC., TROY, NY

Mr. **Sperrazza**. First of all, I would like to thank you for holding this hearing. I would particularly like to thank Senator D'Amato for having reacted the way he has.

After the first hearing that he held many of my colleagues in the industry and business have said it is the first time in 20 years anything has actually happened or looks like it is going to happen. In previous testimony and my colleague here, Dan Brush, have gone over and touched on many points that I will leave out of my full statement. I will just touch on a couple of things that I think have not been covered.

First of all, I think you might all find it interesting—as I was eating breakfast this morning, the headline in the paper today, "High-Tech Crisis Looms Over the U.S.A." "U.S.A. has blown its lead in high technology, and the problem soon to become a crisis," warns a new study. Foreign competition has ruined Silicon Valley says the Council on Competitiveness, and so on.

That bearings are strategic to an industrialized nation is an accepted conclusion, Senator, but I thought you might find it interesting, Senator Weicker, that the bomb site bearings that you were talking about were produced by Barden and Miniature Precision Ball Bearing. And Miniature Precision Ball Bearing was the founder of this industry along with Barden and the IBM in this industry. And today has been driven into a niche of the market. And just to give you an idea of what has happened among the people and the players in this country in this industry.

Before I focus on the problems, my business has encountered—we are manufacturers of precision miniature ball bearings in Troy, NY—but I would like to go over a few points. And I would like to let it be known that the industry as a whole has continued to be battered. New Departure Hyatt, which was a division of General Motors, discontinued operations in miniature bearings. Fafnir discontinued its operations in miniature bearings. SKF Microtech sold out to the Japanese. Barden, you have already heard the story. MPB, as they said, the IBM of this industry and the founder worldwide, has retreated and retrenched into a niche market.

There was a statement that you read before about New Hampshire Ball Bearings.

Senator **Weicker**. Senator Rudman's statement.

Mr. **Sperrazza**. I have an addition to that. New Hampshire Ball Bearings, and this was already prepared, which had more success than any other company in the world competing in the industry against the Japanese and whose founder's dying words were to keep my company independent, sold out to the Japanese in 1985, a deal that couldn't be refused by subsequent management. The promise was large investments, more stable jobs. The payoff was from 1,100 workers down to 535. The miniature bearing facility was closed.

Now, New Hampshire Ball Bearings was the only company in the world that was effectively mass producing miniature ball bearings in competition with the Japanese. They had technology nobody in the world had. I am in this business 20 years, Senator. I know that, and I was one of the top 10 stockholders. Do you know where that equipment is today and that technology? It is shipped overseas and that facility closed. It was the only facility that could possibly compete with some of this low labor, things that my colleague was talking about.

So, I do not know what a great boost that thing was. And another ironic thing was after, subsequent to the purchase, the then-chairman, who wound up concluding this deal after he became then the chairman of Minebea here in the United States, told me, Gus, he said, the minnow swallowed the whale. We were winning the war and we didn't know it. We were competing. We just didn't know it.

And this thing about you cannot compete, you can. And it is going to fall in with the rest of my pattern of my testimony that I think that if the Japanese feel that they cannot beat you one way, they will buy you. I mean there is no way that they are going to stop from getting 80, 90 and 100 percent of that market. And I am going to keep driving that point home and leave the rest of my testimony just written.

Anyway, New Hampshire was the only one that had any kind of success against Minebea, so they bought them. That left us, Kubar Bearings. Now, we are the only remaining mass production manufacturer of miniature precision ball bearings left in the United States that is American owned. Minebea, of course, has a plant in Chatsworth, CA. Realizing that these bearings by law had to be made in the United States, we invested $5 million in plant and equipment to help to fill this need. The U.S. DOD market was substantial and was growing. We knew that the Japanese were formidable competitors. We had imported from Japan for many years and were very, very well acquainted with it. But the DOD demand had to be filled with U.S. made product.

The bottom line is a lot of that product is being filled illegally from overseas production. As a result, in October 1986, Kubar filed for protection from its creditors under Chapter 11 of the U.S. bankruptcy laws. Our employees as a result live daily with the concern of how they will provide for their families. Kubar is producing at one-third of its plant capacity, which means that we have one-third of the workers we should have. Kubar uses one-third of the materials it should. Since our materials are American made, it means less jobs for our suppliers. And needless to say, the outlook for our employees' benefits and advancements have been slim.

Recommendations—I have given you a brief pattern. Before turning to a couple of recommendations I would make, I think you have to get at the root of the problem. If you look throughout the industrialized nations in the world, Switzerland, France, and Germany, they each have a miniature bearing industry. They each guard it. None of those countries has posed the threat to our national security. None of those countries has come in here and determined to take 80, 90, 100 percent of the market. Only one, and I want to say something else.

Everybody seems to think, you know, when it comes from Japan, they have just in time delivery, and they have superior management, and they have this technology, and they have that, and that is what really makes it go, go, go. We do business with 12 small firms in Japan that produce ball bearings. They subcontract. They make our label and make them to our design. Those 12 firms have over the past 18-19 years had relatively stable reasonable growth rates. They have gotten normal patterns of activity in the marketplace. They do not resemble anything like the cartel-supported groups. Six cartel-supported groups have 90 percent of the imported market share here in the United States. The other 12 that are not supported by the cartels, that are not backed by Japan, Inc., are minuscule. They have 5-10 percent of the whole share of bearing production in Japan. So, I want to point out that difference of what happens to be a bearing company if it is supported by Japan, Inc., and what happens if it is not.

It is not superior management. It is not just in time delivery and it is not all those other wonderful amazing things you hear. It is the fact that—and I have given previous testimony on this in my first hearing with Senator D'Amato, so I will not go through it—it is the protection that comes via the cartel safety nets. They remove the risk for the company, and then the company can go ahead, march ahead in its targeted industries without risk to itself knowing that Japan, Inc. and its cartel will support and back them up.

Now, besides the fact that we have the cartel safety nets, the other major point that I have to make are certain Japanese companies systematically avoid, evade, disregard, ignore or break any rule, regulation or law which may hinder their goal of absolute control and domination at any cost. Now, some of these that have occurred and continue to occur—and where I get my information from is just being in the industry 20 years, Senator—nothing to do with what Justice has done, although I am aware of what they have done—substitution of materials without advising customers or DOD, and misrepresenting the material for the one specified. Certain steels are easier and cheaper to machine, but they do not have the same desirable qualities such as hardness and corrosion resistance.

One company, Nippon Miniature Bearing, has substituted different material and represented that material specified. Not only did they substitute it, they substituted and said it is this one, the other one.

Dumping and predatory pricing, I think we have heard some testimony on that, and that will come out further. I think we have heard some testimony on duty avoidance and underpayment and misrepresentation of imported products as U.S. made for DOD.

A little comment on predatory pricing, a directive from the chairman of NMB, for sales not to coordinate with production, promise any delivery necessary and not lose any orders due to low prices, requests of our customers—I am quoting a letter by our chairman. In other words, no bottom to the pricing. And anywhere our company is particularly—no bottom to the pricing.

And, Senator, another interesting point is at the same time that these practices are used to drive the last remnants of our industry out of business, they boast about being the largest suppliers to the

Soviet bloc. Isn't it fascinating that our DOD shares joint suppliers with the Soviet Union and our mutual suppliers are supplying our missiles, aircraft, and other sophisticated weaponry. And in order to ensure that their product, ball bearings, function, they have to naturally study the application.

I thought it was our understanding that our allies were bound by mutual agreement not to supply the Soviet Union some critical goods such as precision bearings.

As I said previously, thanks to action taken based on a previous hearing, these practices are being brought to light and progress finally appears to be on the horizon.

To give you an indication of how deep-seated and how pervasive the problem, consider the following. Those in the industry, my colleagues, for decades freely acknowledged the misdoings that I have mentioned for years. But in the case of NMB which, by virtue of its predatory pricing disregarded all the rules and regulations, and ultimate purchase of its main competitor in the United States controls over 90 percent of the U.S. market.

But, Senator, listen to this particularly. When people in the industry are asked about these practices, they are afraid to speak up. The typical response is, "Yes, I care about the country, but I care about my family and business first. And if anybody finds out I said anything that will shut me off of product, and in this business I cannot survive without them anymore. Besides, what is the Government going to do? They have done nothing for 20 years. Now the Government couldn't do anything even if they wanted to because they are too dependent on them and they know it."

"And by the way, Sperrazza, since you have helped to bring these things to light, they have got you marked as soon as the smoke settles."

Wasn't NMB clever? They raised prices just in time to get away with all the dumping. There is something about the Department of Commerce can only go back 6 months or so from the filing of the complaint. NMB got their price increases in just under the wire. Clever, are they not? They say they will get away with it again.

Now, Senator, with over 90 percent of the mass market where they are able to price virtually at will, they will be in a position to target the remaining U.S. manufacturers who have retreated into the niche markets, and this is exactly what they are doing. All of this will be impossible without Americans letting it happen either out of fear, lack of awareness, lack of concern or a feeling of helplessness. In view of the foregoing, I would recommend strict adherence in enforcing of the regulations that have existed and have been ignored.

For example, the FAR. There is no question that FAR manufactured bearings have been supplied and utilized knowingly by both suppliers and users for years and years to the detriment of domestic manufacturers.

Additional examples. Customs regulations require all bearings with outer diameters larger than ⅝ inch be marked. They enter the country unmarked basically, so they can avoid proper identification and be passed off for something they are not. Imposition of the severest penalties and barring from future business by violators supplying DOD such as misrepresentation of country of origin and substitution of materials which could pose a threat to life and property. Also, swift imposition of current remedies such as the section 232, the dumping investigation. Also, I feel that there should be cohesive resolve throughout our current structure of Government to do something about this. Also new legislation I think needs to be enacted.

And I am going to conclude. Congresswoman Johnson had a couple of comments from Clyde Prestowitz's book, "Trading Places." I would like to finish one of the comments she started, and that was in 1981. By the way, Clyde Prestowitz was counsul for Japan affairs to the Secretary of Commerce.

In 1981 the United States, although less dominant than previously was still the world leader in industry, technology, and finance as well as military power. In 1987 it was the leader only in military power and even this was facing the necessity of reducing commitments.

In other areas the United States which had played the role first of occupier and then of protector and mentor, had traded places with its former protege, Japan. If the military power does not have an industrial revenue base and leading technology, it, too, will fall.

I am going to skip over and conclude with just a couple of comments and a couple of quotes. During Mr. Prestowitz's visit to Japan in 1986 and discussion with Mr. Akio Morita, chairman of Sony Corp., Mr. Morita wondered whether the United States knew that it was throwing away its industry and whether it understood the consequences of that carelessness.

A question by Mr. Keichi Konaga, a former vice minister of the Ministry of International Trade and Industry struck forcefully as he addressed the question to the United States, "why don't you wake up?" That is from the Japanese, gentlemen.

I believe it is time to wake up, wake up and enforce our current trade regulations, grant relief under the current remedies such as the 232 petition in the dumping action, send cohesive signals throughout the Government to our industry, and begin enacting new legislation that will not allow one critical industry after another to be knocked off, ultimately draining this Nation of its wealth, preeminence, and ability to lead the free world.

And my final comment, Senators, the consequences of doing something slowly will be the same as doing nothing. Thank you.

[The prepared statement of Mr. Sperrazza follows:]

PACAMOR
KUBAR

September 2, 1988

Honorable Dale Bumpers, Chairman
United States Senate
Committee on Small Business
Washington, DC 20510-6350

Dear Mr. Bumpers:

I. The Situation - grave

Gentlemen - (Senator) - I apprise you of a situation of utmost gravity to:

1. An Industry
2. Our national security
3. Ourselves and as a nation - leaders of the free world.

II. Ball bearings:

That bearings are strategic to an industrialized nation is an accepted conclusion. Two coffee cups of miniature precision ball bearings altered the balance of power between the U.S. & U.S.S.R.; obtaining them allowed Soviet missiles enough accuracey to strike targets within the U.S. (ref. New York Times, February 6, 1983 - Casper Weinberger - then Secretary of Defense).

One of the Ultimate ironies during World War II involved bombing sites for our aircraft which required miniature precision ball bearings to obtain the desired pin-point accuracy; among the first targets were the ball bearing plants of Nazi Germany.

As I focus on the problems my business has encountered from foreign competition, let it be known that the industry as a whole has continued to be battered and faces continued erosion past the point of return.

III. Kubar Bearings, Inc. - the last remaining U.S. owned mass production manufacturer of precision miniature and instrument ball bearings.

1. N.D.H. - division of G.M. discontinued operations.
2. Fafnir - division of Ingersoll Rand discontinued manufacture of these items.
3. SKF, Microtech - sold out to the Japanese.
4. Barden - effectively discontinued manufacture of these items.
5. MPB (Miniature Precision Bearing) - the founder and IBM of the industry worldwide has retrenched into a niche market.

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6. NHBB (New Hampshire Ball Bearings) - which had more success than any other company in the world competing in the industry against the Japanese and whose founder's dying words were to "keep my company independent" - sold out to the Japanese in 1985 - a deal that couldn't be refused by subsequent management. The promise - large investments, more stable jobs - the payoff - from 1,100 workers to 535; the miniature ball bearing facility - closed.

7. Kubar Bearings, Inc. -
    a. Realizing that by law all miniature and instrument ball bearings with an O.D. of less than 30 millimeters for DOD applications must be manufactured in the U.S. and
    b. That the U.S. DOD market was substantial and growing,
    c. Invested in excess of $5,000,000 for new plant and equipment to help fill that demand. And Senator, that demand has been substantially filled illegally by imported products, rather than domestically manufactured products!!!

October, 1986, Kubar Bearings, Inc., filed for protection under Chapter 11 of U.S. Bankruptcy Law.

a. Our employees live daily with the concern of how they will provide for their families if suddenly the worst happens - the worst hangs over everyone's head daily.
b. Kubar is producing 1/3 of plant capacity; which means we have 1/3 the workers we should have.
c. Kubar uses 1/3 of the materials it should - since our materials are American-made it means less jobs for our suppliers.
d. Needless to say, the outlook for employee benefits and advancement have been slim.

IV. Recommendations:

One must get to the root of the problem before recommending solutions.

a. All of the industrial nations of the world have their own bearing industry - France, Germany, Sweden, Switzerland, Italy, Canada, etc. - only the Japanese have threatened ours with extinction - because bearings are one of MITI's targeted strategic industry and they come under the protection of cartel "safety nets" which will come to their rescue in time of trouble and which will allow them to outspend any company they target.

Let it be clear that we have done business with Japanese bearing companies that do not fall under the protection of cartel "safety nets". Their ways of doing business are completely different. Senator, there are a handful of major bearing companies that fall under the cartel safety nets; and twice as many that do not. In excess of ninety percent of the Japanese production comes from the handful within the safety net. If the Japenese formula for success was just in time delivery, superior management, a better work ethic, etc., these other companies not under cartel subsidy would have mushroomed and been a threat to our industry also. But Senator, not one, not one has made any significant inroads that would threaten our industry - infact, all dozen or so together don't threaten our industry. Each of these individual companies has sold into the U.S. market, sought profits in a normal manner and have been mindful of our regulations. For the most part, they have normal, healthy growth patterns - they rely on market forces unlike the cartel bearing companies that are on subsidized international missions of seek and conquer at any cost.

b. Certain Japanese companies systematically avoid, evade, disregard, ignore or break any rule, regulation or law which may hinder their goal of absolute control and domination at any cost. Some that have occured and continue to occur are:

1. Substitution of materials without advising customers or DOD and misrepresenting the material for the one specified. Certain steels are easier and cheaper to machine, but they don't have the same desirable qualities such as hardness and corrosion resistance. One company, NMB, has substituted a different material and represented it as the material specified!!
2. Dumping/and predatory pricing
   There are cases where prices have been dropped by 50 - 70% and bear absolutely no relationship to cost; the clear cut purpose to prey upon the market - drive out the American competition and then raise pricing.
3. Duty avoidance/underpayment
4. Misrepresentation of imported products as U.S. made for DOD.
5. Noncompliance with regulations requiring bearings with an outer diameter of 5/8" or greater to be marked with country of origin. Only days ago NMB was busy scurrying about the market trying to recover bearings which should have been marked with the country of origin! Meanwhile they claim no wrong doing. I have some of those bearings with me!!
6. Predatory pricing in the market place - a directive from the chairman of NMB for sales not to coordinate with production - promise any delivery necessary - and not lose any orders due to low prices requested by the customers. In other words - no bottom!! A directive to the sales force that wherever Kubar is - there is no bottom to the price.
7. And Senator, at the same time that these practices are being used to drive the last remnants of our industry out of business - they boast about being the largest suppliers to the Soviet Bloc!! Isn't it fascinating that our DOD shares joint suppliers with the Soviet Union and these mutual suppliers are supplying our missiles, aircraft and other sophisticted weaponry. And in order to ensure that their product functions - they must naturally study the applications. It was my understanding that our allies are bound by mutual agreements not to supply the Soviet Unions certain critical goods - such as precision bearing!!!

8. Thanks to action taken based on a previous hearing, these practices are being brought to light and progress finally appears on the horizon.

But to give you an indication of how deep-seeded and how pervasive the problem - consider the following:

a. Those in the industry for decades freely acknowledge the misdoings for years - but in the case of NMB - which now by virtue of its predatory pricing, disregard of all laws and regulations and ultimate purchase of its main competitor in the U.S. controls over 90 percent of the U.S. market share.

However, when people in the industry are asked about these practices, they are afraid to speak up. The typical response is - yes, I care about the country, but I care about my family and business first and If NMB finds out I said anything, they will shut me off of product and in this business I cannot survive without them anymore. Besides, what is the government going to do - they've done nothing for twenty years and now the government couldn't do anything even if they wanted to because they're too dependent on them and NMB knows it!!

And, by the way, Sperrazza, since you've helped bring these things to light, they've got you marked as soon as the smoke settles. By the way, wasn't NMB clever, they raised prices just in time to get away with all the dumping - there's something about Department of Commerce can only go back six months or so from the filing of the complaint. NMB got their price increases in just under the wire - clever aren't they? See, they'll get away with it again.

Now, Senator, with over 90 percent of the mass market, where they are able to price virtually at will, they will be in a position to target the remaining U.S. manufacturers who have retreated into the niche markets - and that is exactly what they are doing!!

All this would be impossible without America letting it happen! Either out of fear, lack of awareness, lack of concern or a feeling of helplessness.

In view of the foregoing, I would recommend;

A. Strict adherence and enforcement of the regulations that have existed and have been ignored.

1. For example, the FAR (Federal Acquisition Regulations) regarding ball bearing purchases. There is no questions that foreign manufactured bearings have been supplied and utilized knowingly by both suppliers and users for years and years to the detriment of domestic manufacturers.

2. Additional ex. - Customs regulations requiring all bearings with outer diameters larger than 5/8" be marked - they enter the country unmarked basically so they can avoid proper identification and be passed off for something that they are not.
3. Imposition of the severest penalties and barring from future business by violators supplying DOD - such as misrepresentation of country of origin and substitution of materials which could pose a threat to life and property.

B. Swift imposition of current remedies such as
   1. Section 232 should be formally acted upon as soon as possible
   2. The Dumping Investigation should be pursued vigorously and if violations are found, swift and severe action taken rather then the usual lip service.

C. Cohesive resolve through our current structure of Government
Although Kubar has generally been supported and applauded for its efforts to modernize, automate and stand up to the Japanese juggernaut - rather than simply give up, sell out or scurry to a niche market - some organizations within the government have been given conflicting signals. As a result, near fatal blows were dealt not only by the Japanese, but also by well itentioned Americans with either mixed signals or no signals at all.

Individuals at the ITA, while personally and professionally concerned and sympathetic with problems experienced at Kubar, were frustrated at attempts of constructive action and as a result the consequences were grave.

D. A clear distinguishing between those Japanese companies that have abided by our laws and regulations doing business in the U.S. and those who have not - mainly the cartel subsidized companies.

E. New Legislation
I quote Clyde V. Prestowitz, Jr., who was Counselor for Japan Affairs to the Secretary of Commerce and is currently Senior Associate at the Carnegie Endowment in Washington, D.C.

"In 1981, the United States, although less dominant then previously, was still the world leader in industry, technology and finance as well as in military power. In 1987, it was the leader only in military power and even this was facing the necessity of reducing commitments. In other areas, the United States, which had played the role first of occupier and then of protector and mentor, had traded places with its former protege - "Japan".

And, if the military power does not have an industrial revenue base and leading technology, it too will fall.

"As part of a study requested by the Cabinet Council on Commerce and Trade, an extensive economic analyses was presented showing that the ability of the U.S. high technology industries to compete had declined across the board and could continue unless U.S. policy was changed".

> "But when U.S. industries have faltered in the face of Japanese competition fostered by Japanese government policies aimed at achieving industrial leadership, our government leaders have agonized over what to do. They have hesitated to enforce U.S. Trade laws even in cases of clear violations".
>
> "The Japanese government views industrial performance as akin to national security - and had long focused on the strategy of building superior industrial structures, thinking of it not only as a means of obtaining wealth, but also, as a tool for enhancing national power".
>
> "American national security is narrowly and militarily oriented, focused on how many carriers, planes and missiles we have. Our government has not attempted to change the structure of a whole industry to achieve the strategic power that domination in that industry would confer.
>
> "The Industry leaders who are behind the sematech effort acknowledged that the days of the lone rider were over, and that the future depended on the U.S. government and country at large. Operating by themselves, they said, the only possible strategy was to abandon any market the Japanese entered in force, which meant that the U.S. producers would always be confined to relatively small markets".
>
> During Mr. Prestowitz's visit to Japan in 1986, and discussion with Mr. Akio Morita, Chairman of Sony Corporation, Mr. Morita wondered whether the United States knew that it was throwing away its industry and whether it understood the consequences of that carelessness.

A question by Mr. Keichi Konaga, a former vice minister of Ministry of International Trade and Industry struck forcefully as he addressed a question to the United States:

"Why don't you wake up?" Gentlemen, I believe it is time we wake up - wake up and

1. Enforce our current trade regulations.
2. Grant relief under current remedies such as 232 and the dumping action.
3. Send cohesive signals throughout government to our industry.
4. Begin enacting new legislation that will not allow one critical industry after another to be knocked off ultimately draining this nation of its wealth, preeminence and ability to lead the free world.

THE CONSEQUENCES OF DOING SOMETHING SLOWLY WILL BE THE SAME AS DOING NOTHING.

Sincerely,

A. J. Sperrazza, Jr.
Chairman and CEO

AJS/sjh

PACAMOR KUBAR

A. J. Sperrazza, Jr.
Chairman of the Board

28 September 1988

United States Senate
Committee on Small Business
Russell Senate Office Bldg.
Room 428A
Washington, DC 20510

Attn: Tracy Crowley
Hearing Clerk

Dear MS. Crowley:

In response to questions submitted by Senator Lowell Weicker, Jr.:

Q. Mr. Sperrazza, will your company benefit from DOD's new acquisition regulations?

A. Kubar Bearings, Inc. will not benefit from DOD's new acquisition regulations although other U.S. manufacturers should benefit.

All of the products within Kubar's size range - up to 1" outer diameter were covered by the previous FAR. The problem is and was- the regulation is not enforced or monitored!!! Therefore, DOD applications have been supplied with foreign made product. The new regulation (which increases the coverage of bearings to bearings with outer diameter of larger than 1") will help other U.S. manufacturers if it is enforced.

Q. Would an affirmative action by the President on the 232 petition save your company?

A. An affirmative action by the President on the 232 petition would certainly be a step in the right direction for us and be welcome; in itself, however, it would not save Kubar. What would save Kubar would be a cohesive signal to a government agency, the ITA - to affectively discontinue its position of relentlessly trying to obstruct any progress we make and force us out of business.

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TELEPHONE 518-283-8002 TELEX 145388

Senator, for your information:

The ITA essentially forced the Company into a Chapter 11 Bankruptcy proceeding by:

1. Being intransigent in responding and attending meetings;

2. Backing out of a commitment signed by ITA and nine other parties, allowing needed funds to be injected into the Company which had already been raised;

3. Acting in such bad faith as to cause a major creditor (Home and City Savings Bank - $3,000,000) to focus its attentions and energies on the bank's problems with the ITA rather than the issue at hand - injecting needed additional funds which had already been raised into the Company;

4. During the Chapter 11 proceedings the only creditor of nine the Company has had to fight in court has been the ITA. Each time the ITA has tried to block funding for Kubar, each time the ITA has lost. ITA appealed the first decision - it lost that too;

5. In a most unprofessional manner, the ITA attempted to seek a purchaser for Kubar - neither agent nor the intended purchaser were informed - everyone was embarassed. The intended purchaser indicated that if they had been fully aware of the circumstances, they never would have appeared in our plant.

   Note: All of this lack of cooperation was very perplexing in view of the fact that Kubar is now manufacturing in the U.S. products which its parent used to import from Japan, thereby accomplishing one of the ITA objectives in its program!

Today, as Kubar is very near to success and as the abuses of the Japanese become apparent and are dealt with, the ITA continues on its road of attempting to close our operation!!

Putting an end to this type of action would save this company today!!! And, any help you could would be greatly appreciated by all of our employees.

In response to questions for Gus Sperrazza:

Q. When the Japanese cartels, acting under the coordination of a Japanese government agency, the Ministry of international trade and industry, target U.S. industries that are vital to our national security for Japanese dominance, do you believe that the Japanese understand that they are undermining our ability to defend ourselves, and, indeed, to keep our commitments to all of our allies, including Japan?

A. I believe that the Japanese view targeting industries vital to our national security as an opportunity to enhance "mutual interdependence." And, if our government does nothing to stop that progress it is an indication that somehow, as incredible as it may seem - since the Japanese would never allow it, our government either condones it or is negligent.

It is interesting to note that when a foreign company - Trafalgar - was attempting to take over NMB (Nippon Miniature Bearing) one of the reasons cited to prevent a possible take over was that the bearing industry and NMB were vital and strategic to the defense of Japan and would be blocked on that basis!!! Meanwhile, the Japanese allow virtually no foreign presence in their miniature bearing industry - and ours in the U.S. is already 90% controlled by the Japanese!!

Q. In your prepared statement, you said that "with over 90% of the mass market, where they [the Japanese] are able to price virtually at will, they will be in a position to target the remaining U.S. manufacturers who have retreated into the niche markets -- and that is exactly what they are doing!!" Most of those niche markets are somehow related to government, or specifically, to defense procurement. Why, in your view, would the Japanese want to wipe out all U.S. bearing manufacturers?

A. With the Japanese fully in control of the U.S. bearing market, and our industry and defense dependent on their supply, not only would it be a means of obtaining wealth but of tremendously enhancing Japanese national power! We as a company currently negotiate with companies to pay their open accounts due to us becuase they can't assemble their products without our bearings. Conversely, it would be an unfavorable situation for the U.S. to be in a position whereby weapons systems could not be assembled without foreign bearing suppliers. That situation gives tremendous leverage to the supplier.

Q. You lived in Japan for three years and have dealt with the Japanese in business even longer. What is your explanation of this sort of predatory Japanese conduct?

A. Achieving dominance in an industry confers wealth and also national prominence and leverage in international dealings; the Japanese believe that our government either:

a. Approves of Japanese dominance by virtue of the fact that we do nothing to prevent it -

or

b. If Japanese dominance is allowed by virtue of our own negligence or ineptitude,

In either case, they might as well exploit the situation to the fullest.

In Japan - these decisions and dealings are conferred upon the highest level and strata of Japanese society - the best students from the best universities - and they are career positions. In our society often our negotiators are relatively ill equipped - either lacking in experience, background or job tenure to effectively deal with their Japanese counterpart. Often the Japanese will begin a circle of discussion about a problem - that has already gone full circle with a previous American official - knowing full well that the discussion will produce nothing - since it produced nothing the last time with the previous U.S. representative. But, it buys time with the U.S. representative and in that time they will be able to achieve the goal of total dominance - and then there is nothing left to negotiate about. We have lost.

Respectfully,

A. J. SPERRAZZA, JR.

AJS/cm

Senator D'AMATO. In your prepared statement you have made a number of serious allegations against Nippon Miniature Bearing Co. which is a wholly-owned subsidiary of Minebea, a Japanese company. What share of the U.S. market do you believe that Minebea now controls, either directly or through its two U.S. subsidiaries, Nippon Miniature and New Hampshire Bearing?

Mr. SPERRAZZA. I believe the figures would be approximately 90 percent. However, since they have 90 percent, everybody sort of dances to their tune, so almost effectively they are calling the whole tune and dance in the United States.

Senator D'AMATO. Mr. Brush, would you agree with that?

Mr. BRUSH. I don't have as much detailed information as apparently Mr. Sperrazza has, but that would not surprise me at all.

Senator D'AMATO. Would it be fair, would I be putting you on the spot if I asked you if you shared many of the sentiments which you have just heard Mr. Sperrazza testify to?

Mr. BRUSH. Oh, yes, absolutely I would agree and share the sentiments.

Senator D'AMATO. Let me ask both of you, in your opinion is the Minebea case the worst one out there or are there other similar cases that just haven't come to light?

Mr. SPERRAZZA. I would have to say in my opinion the Minebea is the worst. I have never seen anything like this. We have competed in a broad range of bearings, but the predetermination—I have had the pleasure of having met Mr. Takahashi and spoke to him. I know what his game plan is, and he is going right down that path. Now that I have 90 percent of the market, or whatever it is in miniature bearings, now we are going to target after the other two niches, which is Barden and MPB, and go after them. I have never seen one Japanese company—it is Miniature Precision Bearings, somewhat similar to Barden. It is another company, the founder of, the IBM, driven into a niche. So, this company has got 90 percent of the mass market, and now it is going after the remaining few percent in the niche market.

Senator D'AMATO. Why would it want to do that? Would it not be self-defeating?

Mr. SPERRAZZA. Total control.

Senator D'AMATO. Do you agree?

Mr. BRUSH. Absolutely, and they are doing it.

Senator D'AMATO. You have heard Mr. Sperrazza testify the fear of those who are doing business with Minebea, to the fact that they are very much concerned that if they do business with you or with a competitor of Minebea's, or if they raise any of these allegations, and so forth, that they would be blacklisted.

Have you ever come across any of that?

Mr. BRUSH. No, I have not. However, let me clarify what I think Mr. Sperrazza was saying. It was not so much—it is the customers of ball bearing manufacturers that are concerned that they could be cut off or actually let us say that that was not even the case. There would be concern that if they had to buy American, that the American ball bearing industry could not supply their needs. That is an absolute fact and not an opinion.

Senator D'AMATO. Have you run into those situations?

Mr. **Brush**. We know of one situation. I am familiar with one particular situation.

Senator D'**Amato**. The dominance of this industry also creates a situation where there is a loss of free will on the part of the customers. They are very much concerned that they are placed in a precarious position. If they were to give you some business or Mr. Sperrazza's company some business, they might find themselves cut off from an adequate supply.

Mr. **Brush**. That is correct, and I think within the next 6 months or so we are going to see what effect the new Federal acquisition regulation is having. We are already starting to get calls from customers who have been buying foreign bearings and we have been invited in to start to talk to them. What effect this is going to have on our business we really do not know.

Senator D'**Amato**. You mean because you may not be able to meet the requirements, therefore customers will petition the Government to relax these requirements because their needs cannot be met. It is a Catch-22. It is a real fiasco, is it not?

Mr. **Brush**. Yes.

Senator D'**Amato**. Mr. Chairman, I have to tell you this is really incredible. It is not easy to see how we can work our way out of the situation, but work out of the situation we must. We cannot allow our vital industries to be subverted. There is virtually no competition in so many areas involving just consumer goods, but now our national defense is involved. There is no doubt in my mind that exactly what Mr. Brush and Sperrazza have predicted will probably take place in a relatively short period of time, and then we will look very foolish. And we will have some of our foreign competitors chortling at the fact that, "Well, you see, you have put this law on the books and now you cannot even make it work."

Well, after the industry is destroyed, giving it an opportunity to compete is like keeping somebody out in the desert, starving them, not giving them any water, and then inviting them to a full-course banquet when they are on death's bed and say to them, "Here, you can eat all you want." You cannot reverse overnight, the process that has taken place for so long. I think foreign companies absolutely understand this. They do this by taking on the highest paid lobbyists very well-connected people, by stalling effective United States responses, by paying incredible sums to consultants. We literally have people who are busily engaged in protecting their clients as their clients run smack into the interests of this country against our security interests and our standards of fair play and decency.

I want to thank the two witnesses, and I want to thank you, Mr. Chairman, for your holding of this hearing.

Senator **Weicker**. Thank you very much, Senator D'Amato.

Let me ask both of you if for whatever reason the Japanese production of ball bearings was foreclosed entirely to this Nation, could we meet our defense needs? And question number two, could we meet our defense needs as they now exist, could we meet defense needs if those needs were accelerated by any conflict?

Mr. **Brush**. I think if you do the arithmetic, the defense needs at the present time are only 15-20 percent and that you would have to say yes. If magically the bearing industry could suddenly turn itself around and only supply defense needs, they would. Where the problem is is how many times do you multiply that, and our own figures with the Vietnam war, it is five times what we are producing now, and the answer is there is absolutely no way that we could respond to that.

Senator **Weicker**. You could probably respond to it under present circumstances, but not under circumstances that would have to be accelerated in terms of being in a conflict.

Mr. **Brush**. That is correct. And when I say under present circumstances, it would take time, but it could be done and it might require regulation. It might require requirements coming from the DOD that thou shalt do this and you will not take an order for commercial bearings. You will supply to the DOD.

And there are regulations available to the DOD to do that. And if they did that, it would seem to me within a period of time this probably could be met.

Senator **Weicker**. But in doing that, you would probably have to cut off commercial.

Mr. **Brush**. We certainly would.

Senator **Weicker**. How about you, Mr. Sperrazza? Do you agree with that?

Mr. **Sperrazza**. Yes, I agree right down the line. And by the way, Senator D'Amato, what I was referring to was not only the customers, but particularly the distribution system in the United States. The distributors to a very substantial degree are so dependent on 90 percent of their product being Japanese NMB that if they dare——

Senator **D'Amato**. Are you saying that in your efforts to compete and to sell your ball bearings you had distributors say, "Look, I cannot do it because if I undertook it, I would be cutting my own throat because they would cut me off?"

Mr. **Sperrazza**. You got it.

Senator **Weicker**. Let me turn the question around now. Let us assume that we foreclosed to the Japanese all defense oriented ball bearings. We are saying that all have to be of American manufacture. Do we have enough firms in the United States to supply the competition to assure both quality and price to our own defense establishment or has this attrition that has taken place over the years reduced us to the point where we are at the mercy of one or two American companies?

Mr. **Brush**. Well, I think that is true. We are at the mercy of one or two American companies, particularly in the super precision business. As Mr. Sperrazza says, Fafnir is out of it. New Hampshire Ball Bearing no longer has that capability. That has been shipped overseas as he has pointed out. MPB, Miniature Precision Bearing, which is in New Hampshire also, and ourselves.

Senator **Weicker**. Torrington?

Mr. **Brush**. Torrington does not make super miniature precision ball bearings. We are talking—super precision bearings that go up in large size as well.

Take the "noise quiet" bearings for submarines that we supply. We had a $4 million order for that. That was an entire 2-year supply for all the Navy's requirements for "noise quiet" bearings, so the answer is yes, we do have enough capacity there right now.

And that had been supplied by NTM, a Japanese company. Now, we should have some of the business, and we are qualified on all sizes.

So, when you get into flight control systems, gyros, any volume of super precision bearings, I think we would probably have a problem. Certainly short-term there would definitely be a problem. And short-term I would think it would take 1 year to 2 years for a Fafnir or others to ramp up and get the equipment, train people, and start successfully producing super precision bearings again.

Senator **Weicker**. Let me ask you a question in that regard. Where is most of your equipment made that manufactures the ball bearings?

Mr. **Brush**. Most of it is made in this country. We have a pretty good machine tool industry in this country.

Senator **Weicker**. I have also seen that industry eroded.

Mr. **Brush**. Absolutely. But we do have some foreign made machines in our factories, but we could use American made machines. They make good machinery.

Senator **Weicker**. One last question because we have three more witnesses, and I do have to bring things to a close here in a matter of the next 20 minutes or so. How important do you consider the 232 decision to be made by the President within the next month or so, within the next month and a half?

Mr. **Brush**. By the 21st of November? I think it is critical.

Mr. **Sperrazza**. I do too, Senator, not that it is the ultimate thing, but at least it will do something until a complete policy and legislative format can be developed. At least it will do something to stop the onslaught, and I think it is very critical.

Senator **Weicker**. I get back to the example that I used before because I think it is quite accurate to our defense. When I discussed the bombing of Germany's oil fields or oil storage I guess is a better way to put it, and the ball bearing plants, in effect both are a national resource to a defense establishment. They are that critical. They are a natural resource. I realize that I am bending semantics, but insofar as the effect is concerned, there is no difference. Thank you very much.

Our next panel of witnesses will include Robert McCormack, the Deputy Assistant Secretary for Production Support of the Department of Defense, Tim Bergan, Deputy Assistant Secretary for Import Administration, Department of Commerce, and Lee Mercer, Deputy Under Secretary, Bureau of Export Administration.

Gentlemen, welcome to the Committee. I would hope that any prepared statements would be included in the record in its entirety in order that within the next 15 minutes we on the Committee can ask you as many questions as possible. Why do we not we lead off in the order that I announced the witnesses. Mr. McCormack.

STATEMENT OF ROBERT C. McCORMACK, DEPUTY ASSISTANT SECRETARY FOR PRODUCTION SUPPORT, U.S. DEPARTMENT OF DEFENSE, WASHINGTON, DC

Mr. **McCormack**. Good morning, Mr. Chairman. Senator D'Amato. I appreciate the opportunity to share the Department of Defense perspective facing the domestic ball and roller bearing industry. As you suggested, I will address it in terms of the effect foreign competition has on our national security; where we are today, and what Congress can do to help remedy these problems.

With your permission, I will summarize my statement and submit the full text for the record.

Let me begin by saying the Department of Defense considers the bearing industry to be as critical to our military readiness as munitions or weapon systems. Bearings are not only used in these items but are essential in their production.

We believe it is absolutely essential to have a viable and responsive domestic bearings industry to support crisis requirements. We also believe this industry is faced with a serious decline. The extent of the decline, to the point at which we will not be able to satisfy defense requirements, is due in part to foreign competition.

What are we going to do about it? This is where the debate begins. Let me take a moment to discuss a problem confronting us in a broader context and then address the specific situation.

As you are probably aware, we have just released a comprehensive report entitled "Bolstering Defense Industrial Competitiveness." It concludes, that meeting the U.S. security needs will require a healthy manufacturing base from which the DOD can draw its requirements both in peacetime and in emergencies. Our concern is with those industries which are losing their ability to compete in the international marketplace and are particularly critical to U.S. security needs either because they represent key production technologies and equipment, or their very existence is vital to the technological and manufacturing leadership of the United States. The bearing industry is one such sector.

I will not elaborate on the report details, but it is important to note that the issues and recommendations were not limited to DOD policies and practices. They involved, and I believe more importantly so, those related to the national agenda requiring actions beyond the scope and authority of the Department of Defense.

The competitiveness issue will require not only the DOD, but people both in and out of Government, including Congress, to successfully deal with the problems at hand. I would like to add at this point that we have worked closely with several Senate Members and their staffs in the Senate Subcommittee on Defense, Industry and Technology, and we have collectively worked this important issue.

Because of the limited time, I would be pleased to offer our report for the record on this matter.

[Material follows:]

BOLSTERING DEFENSE INDUSTRIAL COMPETITIVENESS

PRESERVING OUR HERITAGE
THE INDUSTRIAL BASE
SECURING OUR FUTURE

DEPARTMENT OF DEFENSE
UNITED STATES OF AMERICA

Report to the Secretary of Defense
by the
Under Secretary of Defense
(Acquisition)

July 1988

THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301

ACQUISITION

July 15, 1988

TO THE SECRETARY OF DEFENSE:

Enclosed are the results of our examination of the problems facing the United States defense manufacturing base. Our objective was to identify the actions necessary to prepare the Department better to deal with the dynamics of manufacturing worldwide. The recommendations we are already putting into action center around six major thrusts: forging the right relations with industry; improving the acquisition system; establishing defense industrial strategic plans that support our military strategic plans; developing manufacturing capabilities concurrent with development of weapon systems; laying the foundation now for the technical skill base required for tomorrow's defense needs; and ensuring that industrial base issues important to our defense benefit from the full spectrum of potential policy remedies, when appropriate.

An underlying message of this project, which is based on extensive advice from industry, academia, and other Government agencies, is that cooperation is an essential foundation to meeting and sustaining defense goals. Our cooperation with industry, with our allies, with other agencies, and with the Congress is imperative if we are to meet ever more sophisticated requirements with relatively fewer resources. Through this project, we are taking the first steps toward such cooperative relationships. Achieving these relationships, however, is requiring a culture change throughout the Department. Our challenge, as you have stated on many occasions, is to maintain serious and consistent efforts toward this goal. I am committed, as I know you are, to make this contribution.

Attention on the defense industrial base has focused on its problems, many of which have been characterized as insurmountable. While we certainly would not claim to have proposed solutions to all these problems, this project has shown, once again, that the nation is willing to assist the Department. We were most fortunate to have the assistance of a talented and dedicated staff, as well as hundreds of individuals, from Nobel laureates and chief executive officers to production line engineers, who generously gave of their time and ideas. The nation's great untapped resources of commitment and ingenuity are our best promise that the security of future generations can be assured.

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FOREWORD

By Dr. Robert B. Costello
Under Secretary of Defense (Acquisition)

A competitive industrial base is key to deterring aggression and, should that fail, to winning wars. The direct role of our industrial base in waging war successfully has been demonstrated during all major conflicts. Thus, the real thrust of this report is to define Department of Defense options to ensure a strong industrial base that will enable us to react appropriately and successfully to any threat.

The North American industrial base provides the weapon systems (from rifles to aircraft and ships) and the major components (for example, radars and engines) needed by our armed forces. It also provides the important logistics support (including food, fuel, spare parts, clothing, ammunition, medical supplies, etc.) required in wartime or peacetime to sustain operations. Our ability as a nation and a continent to supply this materiel to our armed forces is critical and is the reason why it was necessary to frame the action plan that is the central theme of this report.

Defining the breadth of our industrial base is complicated; we rely on a global market that produces both civilian goods and military materiel. Additionally, our industrial base represents not only the capacity and capability to produce goods at an appropriate rate, but the technology upon which these goods are predicated. Add to this economic and efficiency considerations and it becomes apparent that our industrial base is a highly interdependent and extremely complex structure.

As a customer of the industrial base, the Department's peacetime requirements generally are a small fraction of an industry's capacity. Concomitantly, combat requirements are significantly larger and must be satisfied. By itself, the Department of Defense is incapable of sustaining the industrial base upon which it depends. American industry must, of its own volition, remain commercially competitive in today's world economy. The Department, however, can participate in or lead activities that bolster American industrial competitiveness in world markets while ensuring industry's ability to assume a direct role in supporting our combat requirements.

The Department of Defense initiated this effort in June 1987. During this period, the Department obtained information on bolstering industrial competitiveness from more

SUMMARY

The defense industrial base generally comprises the same manufacturers that produce goods for the general public. Few industries rely primarily or completely on the Department of Defense as their principal market. However, the Department depends on virtually every sector of the manufacturing base for materiel. Ninety-five percent of the manufactured goods purchased by the Department of Defense come from a broad spectrum of 215 industries. In 1985 the Department spent almost $165 billion within these industries. This represented 4.1 percent of America's total gross national product and 21 per cent of the manufacturing gross national product. However, while the Department of Defense is a major purchaser of manufactured goods, we recognize that in many important sectors, such as electronics, we purchase only a small portion of total output. Even so, our market share (even in the electronics industry) can provide us with substantial leverage if properly managed.

In addition to meeting requirements for the production of today's weapon systems, the Department's investment in the industrial base must encourage the research and development for advanced technologies that are key to the next generation of weapon systems. These include technologies such as infrared focal plane arrays, microwave devices, advanced sensors, exotic alloys requiring powdered metallurgy technology, high temperature ceramic composites, and high temperature superconductors. Additionally, advanced manufacturing strategies, such as flexible computer-integrated manufacturing, must be developed for and integrated into the entire industrial base.

As a nation and as a continent, we no longer are totally self-sufficient in all essential materials or industries required to maintain a strong national defense. Consequently, we must identify requirements carefully and assess them against our industrial base capabilities. We must develop strategies that enable us to meet security needs with available resources. For those essential products the United States does not manufacture, we must rely on offshore sources or stockpiles. We can, however, offer incentives to establish domestic manufacturing industries for these products.

Clearly, the Department of Defense cannot provide massive financial assistance for every American industry characterized by a lack of international competitiveness, nor can we effectively provide incentives for every manufacturing industry critical to our defense. The issue of competitiveness is one that requires continuing creativity and innovation within the private sector. There are numerous factors that industries themselves must come to grips with if they are to remain competitive in the international market place. There are also national issues, such as our tax code and antitrust laws, that warrant our attention. Our education system has been cited as providing a less than adequate technically trained labor force for the future. To the extent that these and other national issues affect the industrial base, the Department of Defense intends to stimulate, when warranted, appropriate activities throughout the Government to address them.

Within the Department of Defense acquisition process we have identified several areas that are impediments to efficient defense production. Frequent policy changes, emerging technologies, changing military requirements, the defense budgeting process, and program and budget instability make long–term planning difficult. Typically, small volume purchases and program *stretch–outs* contribute to an environment in which defense contractors have little incentive to make long–term investments in facilities with advanced capabilities that could yield higher quality and more competitive products.

Commercial market rewards for performance are lacking in the defense market. Unit cost reductions, quality improvement, shortened delivery times, etc., neither stimulate demand for additional units nor provide greater market share; nor do unit cost reductions result in increased profit. Emphasis on lowest bid cost may result in inadequate attention to life cycle costs, quality, and past performance.

The Department of Defense reliance upon detailed product and process specifications can be counterproductive. Outdated specifications frequently reduce innovation, inhibit improvements, and result in excessive administrative processes required to implement, monitor, waive, or modify specifications. Procurement processes focus mainly on prime contractors, even though materials and components purchased by prime contractors from lower–tier industries represent 50 to 85 percent of our total expenditures. Historically, the Department has had limited direct influence on the performance of subtier contractors because of considerable administrative difficulty in passing performance incentives through prime contractors to multiple levels of subcontractors and suppliers.

Finally, layers of bureaucracy and somewhat cumbersome contract administration processes add to the costs of doing business with the Department of Defense.

Government emphasis on oversight activities can lead business managers to focus more on meeting inspection requirements than on improving quality and productivity.

This Department of Defense report is designed to provide both a strategy and specific initiatives to address this concern. Integral to this strategy is a recognition that the Department's influence is, at the same time, significant and limited. The strategy suggests exploiting the Department's leadership and leverage potential to strengthen the industrial base, but not to the exclusion of other Departmental priorities such as a well equipped force structure. On the other hand, it is neither possible nor desirable for the Department to solve all the ills of the commercial manufacturing sector.

The cornerstone of this effort is cooperation with domestic industry and our allies. The United States could not build fortress America, even if this were a desirable objective. Nor can the Department of Defense reverse worldwide economic trends, such as the internationalization of manufacturing. To maximize domestic industry's potential, cooperative relationships must flourish among the Department of Defense, large corporations, and the lower-tier manufacturing industries that are the foundation of our industrial base.

Embedded in this action plan are six strategic thrusts: (1) forging the right relations with industry; (2) improving the acquisition system; (3) establishing defense industrial strategic plans that support our military strategic plans; (4) developing manufacturing capabilities concurrent with the development of weapon systems; (5) laying the foundation now for the technical skill base required for tomorrow's defense needs ; and (6) ensuring that industrial base issues important to our defense benefit from the full spectrum of potential policy remedies, when appropriate. These recommendations were framed to address the fundamental causes of our industrial competitiveness problems, but we did not attempt to address all the symptoms. The recommendations reflect the complex and long-term nature of the problem and the need for the Department of Defense to establish the institutional mechanisms for a consistent and sustained approach in developing solutions.

We are working also on the shorter term solutions. Based on the findings and recommendations in this report, which were developed over the past year, we already have taken three broad, positive actions to affect our acquisition management process and to increase the Department's emphasis on production and manufacturing.

The Department of Defense will encourage building university expertise in manufacturing by combining a scholarship program in manufacturing with industry and university efforts to build regional knowledge centers. As envisioned, the Department might offer scholarships at universities willing to build world class manufacturing management and technology programs. The schools would be selected based upon a commitment to maintain leading edge university expertise; industry support for endowing faculty positions to enable the world's best manufacturing managers to teach future generations; a commitment from industry to establish hiring programs to assure that the finest career opportunities are afforded to the new generation manufacturing manager; and a state and university commitment for faculty and curriculum development to stay on the leading edge of technological progress. This program should have a minimum commitment of five years from the Department of Defense, but must be matched by industry and participating universities.

Our security, while the explicit responsibility of the Department of Defense, is the implicit responsibility of the entire Federal Government and all the citizens of this nation. The Department has a mandate to ensure the existence of a viable industrial sector to meet defense requirements, both for leading edge technology and production capacity. But, this responsibility does not end with the resources of the Department of Defense. It is incumbent upon the Department to explore all potential solutions. Stated simply, the Department of Defense intends to seek the assistance of other Federal agencies to bolster industrial competitiveness when it impacts our security.

From now on, the Department regularly will seek the advice and assistance of the domestic and economic policymaking organizations of the Executive Branch to find the most cost effective solutions to defense industrial base deficiencies identified by the Department. Indeed, requests for advice and assistance were initiated during the extensive consultations with other departments and agencies which occurred in the effort leading to this report.

Preliminary discussions further exploring this approach have been held with both the Treasury Department and the Cabinet level Economic Policy Council. Both organizations support this concept and believe that more effective approaches utilizing broader policy perspectives should be implemented. This approach potentially could bring to bear the full weight of tax, trade, antitrust and other Government policies in supporting the security missions of this Department.

Brief synopses of the recommendations, together with comments on their current status, are presented in the remainder of this summary.

SYNOPSIS OF RECOMMENDATIONS AND PROGRESS

- ***Forging the Right Relations With Industry*: *Establish a Defense Manufacturing Board (similar to the Defense Science Board) and a Manufacturing Advisory Council (sponsored by an objective third party) to address defense manufacturing issues and problems.*** The Defense Manufacturing Board has been established and the National Academy of Sciences is forming the Defense Manufacturing Strategy Committee.

- ***Strategic Planning Task Force*: *Establish a task force to determine the best means to provide industrial support for military operational plans and determine which ones should be supported by industrial strategic planning.*** Once convened, it will report to the Deputy Under Secretary of Defense (Production Base and International Technology).

- ***Production Base Advocate*: *Establish an organizational focal point to receive, evaluate, and test innovative ideas to improve Department of Defense manufacturing programs.*** The Production Base Advocate's office will be established as the Office of the Deputy Under Secretary of Defense (Production Base and International Technology).

- ***Analytic Capability to Develop Defense Perspectives*: *Establish permanent, institutional mechanisms to acquire, analyze, and assess manufacturing and technology data.*** The Defense Industrial Network (which provides manufacturing data) and Project SOCRATES (which provides technology data) will be merged into a natural language, expert system within one organization, the Defense Industrial Base Information Administration, which will report to the Deputy Under Secretary of Defense (Production Base and International Technology).

- ***Foreign Dependencies*: *Develop and implement systems to provide visibility of critical foreign–sourced items in or proposed to be in new weapon systems, prior to the demonstration/validation decision milestone during the acquisition decision–making process.*** The Deputy Under Secretary of Defense (Production Base and International Technology) will be responsible for assessing foreign dependencies within the appropriate Defense Acquisition Board committees and for reporting the findings to the full Defense Acquisition Board.

CHAPTER I
OVERVIEW

There is a growing perception among American citizens that America's industrial base is on a downhill course to second–class status. Despite general economic prosperity, there is concern over America's ability to compete in the international marketplace. The Department of Defense also is becoming increasingly concerned. Many basic industries of importance to defense production have declined, threatening the responsiveness of our industrial base. Left unchecked, such erosion could rob the United States of industrial capabilities critical to national security. An efficient, responsive, and technically innovative industrial base is necessary to develop and produce high–quality, affordable defense systems and to maintain our ability to deter aggression or defeat potential adversaries.

In early 1987, the Department of Defense Strategy for Bolstering Defense Industrial Competitiveness was launched. This report represents the culmination of the first phase of that effort.

This report is not based upon an examination of the universe of American manufacturing industries, and does not attempt to make the case that all American manufacturing industries are in decline. In fact, for many years manufacturing has remained fairly constant as a percentage of the United States gross national product, indicating, generally, that the American manufacturing base remains healthy and productive.

Major sectors of American industry are vital and highly competitive in both domestic and international markets. Within other sectors that have not yet been subjected to intense import pressures, there are many firms that continue to compete in the domestic market and some that are effective competitors in international markets. Even in industries subjected to intense competition from foreign firms, some American firms have been or recently have become fiercely competitive.

There are, nevertheless, serious indications of decline in sectors of the industrial base that are fundamentally important to national security and to continued American leadership in advanced technologies. From one sector to another, the indications are somewhat irregular, but, from the defense perspective, the issue is too important to ignore and too vital to presume there is no problem.

Particularly devastating in the long-term is the loss of key production technologies and equipment. In some vitally important technologies, such as machine tools and electronics manufacturing equipment, the erosion has been particularly severe. These are but the leading edge of scores of technologies in which other nations are developing the most advanced manufacturing technologies for the most advanced products. Such loss of supremacy in manufacturing technologies is a particularly insidious threat to American technological and manufacturing leadership.

One consequence is that the Department of Defense is becoming increasingly dependent on foreign-sourced hardware and technology in the acquisition of the technologically superior weapon systems that are fundamental to our strategy of offsetting numerical inferiority with technological superiority. We cannot reasonably expect to offset potential adversaries' numerical superiority with only technological equivalence.

We do not know how these developments ultimately will affect our security. We do know that they give cause for concern. Our capacity to build or replace critical force structure independently of economic and political decisions of other sovereign powers is essential to our security. The Department of Defense must ensure that its actions and policies, as well as the actions and policies of other Government institutions, do not weaken our manufacturing sector and thereby degrade the United States' security posture.

As we look to the future, two fundamental problems threaten Department of Defense capabilities to maintain a modern inventory of technologically and qualitatively superior military equipment. The first is the environment in which the Department of Defense and industry conduct business. The high and rising costs of our major weapon systems appear driven by an acquisition system that encourages long acquisition cycles, high development and production costs, and sometimes obsolete technology. This increasingly burdensome environment is a cause of continuing difficulties in the Department's efforts to fulfill its responsibilities to the nation for effective, efficient procurement of major systems.

The first problem is exacerbated by the second — aspects of fiscal and monetary policy and the costs imposed on industry by some necessary but nevertheless expensive domestic policies. Department of Defense-related causes of problems associated with the declining competitiveness of American manufacturing industries are not the only causes of problems within the defense sector. The underlying causes of national competitiveness problems also apply in every respect to firms within the defense industrial base. However, defense-related problems cannot be solved if the broader national-level problems are not resolved. Industry clearly is appealing for the Congress and the Executive Branch to understand and appreciate better the total impact of Government actions and to provide improved coordination and consistency of national policy.

Many congressional and executive intrusions into the market have negative impacts on the competitiveness of American manufacturing industries. The tax code, antitrust laws, and Department of Defense acquisition policies frequently discourage investment in domestic production facilities and innovation by domestic producers. Some elements of United States law more appropriate when America was a more self-contained economy now are harmful to American industry in the international market. Actions to adjust these laws to the conditions of a more international marketplace have been slow and inadequate.

The Department of Defense can contribute to solutions, but cannot unilaterally provide them. Effective solutions will require the cooperative efforts of the Congress, Executive Branch departments and agencies, and the public. We hope that this report will stimulate the beginning of that cooperative effort.

The following chapters: explain more fully the reasons for Department of Defense concerns about United States industrial vitality; discuss the nature and scope of our competitiveness problems and the Department's role in addressing them; explore the causes of and potential solutions to underlying long-term problems; and, finally, offer recommendations for action.

CHAPTER II
THE COMPETITIVENESS DEBATE

A decade of debate about *industrial policy*, as well as today's concern with *competitiveness*, are reflections of major structural shifts in our economy. The many indicators of these changes include the declining role of the goods producing sector and the rising importance of foreign trade and the increasing integration of world capital markets.

This section begins with a brief review of the debate between public policy specialists we surveyed who warn of a broad competitive decline and those who believe that America's industrial performance has been relatively good. These two groups are far apart on their interpretation of *the facts* and correspondingly far apart on their recommendations for action. There are, however, some areas of agreement between them and considerable agreement about the role and responsibilities of the Department of Defense. Framing Department of Defense actions in the context of these larger economic and industrial issues allows the segregation of the Department's policies and responsibilities from those of other agencies and highlights broad areas of policy interplay associated with Department of Defense concerns.

A. UNITED STATES COMPETITIVENESS

The gauge by which analysts have measured United States competitiveness is itself a matter of intense debate. The President's Commission on Industrial Competitiveness and other recent studies have settled on the following definition: *competitiveness for a nation is the degree to which it can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining and expanding the real incomes of its citizens*. According to these studies, statistics on real wages, the trade balance, productivity growth, innovation, and human resources present a bleak picture of America's competitive status. These studies generally contend that these competitive weaknesses are deep-seated, structural, and not quickly remedied. Similarly, they forecast dire consequences if they are not reversed.

Sectoral Decline

In addition to the macro–economic indicators discussed above, some analysts have been concerned with competitive decline at the sectoral level. In particular, they are concerned with the decline of *strategic* sectors.

There are two senses of the term *strategic industry*: strategic for economic growth, and strategic for security. The Department of Defense concerns are most obvious with respect to the key defense–related industries that largely determine both the quality of our instruments of deterrence and the scope of an American response to aggression should deterrence fail. However, strategic industries, in the economic sense of the term, also are of concern.

These economically strategic industries are, by and large, research–intensive industries or industries that exhibit important technological spillovers or *linkages* from one industry to another. Perhaps the best example of such an industry is the semiconductor industry. Semiconductors have been responsible for technical revolutions in supercomputers, home appliances, automobiles, telecommunications, energy, and many other products. The telecommunications industry may be another *strategic* industry, with the potential to stimulate broad cost reductions in communications, decision making, and control technologies. The low–cost availability of energy also provides a strategic *leg–up* to American firms in their ability to be cost competitive.[1] Other *strategic* industries might include computers, office equipment, construction and mining machinery, instruments, and many types of manufacturing equipment, based on their tendency to *export* technology to other industries. Each of these industries has important *linkages* to other industries. They are believed to be essential to long–term economic growth and competitiveness.[2]

The United States historically has been a world leader in the exploration and development of such strategic technologies. Some observers are concerned that even in such technologies, American performance has begun to slide.[3]

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[1] See Peter T. Jones and David J. Teece, "Research Agenda on Competitiveness," Berkeley Business School, Berkeley, CA, 1987, pp. 45–51.

[2] F.M. Scherer, ***Innovation and Growth***, MIT Press, 1984, esp. Chapter 3, "Interindustry Technology Flows in the United States," pp. 32–58.

[3] W. Finan, *et al*, "The U.S. Trade Position in High Technology: 1980–1986," Joint Economic Committee, U.S. Congress, Washington, D.C., 1986.

It is alleged that the Japanese, in particular, understand the importance of these linkages and that they strategically orchestrate public policy — in the form of research and development subsidies and protected domestic markets — to capture vital market shares in these strategic industries. American trade policy institutions have heretofore rejected this approach and are believed by many to be incapable of mounting a strategy to counter active foreign trade policies. Some analysts believe, therefore, that new institutions are required to accomplish these important tasks.

B. OPPOSING VIEWS — SMART PEOPLE DISAGREE[4]

There are at least three grounds for disagreement about competitive conditions in the United States among those who have examined the issues carefully. There are methodological disputes, disagreements about the interpretation of macroeconomic events, and disagreements about the interpretation of sectoral economic events. These are discussed in this section. There are also areas of agreement, which are discussed in the following section. It is in these latter areas that the Department of Defense can most effectively contribute by using its influence in the economic policy arena.

Methodological disagreements pervade the competitiveness debate. Disputes concern both the nature of economic causation (and therefore the selection of the economic phenomena to be explored) and the accuracy of various measures of economic health. On the issue of what causes countries to export and import the mix of commodities they do, for example, (an issue of central importance to understanding international competitiveness), there are differences in approach. While some focus on the distribution of existing stocks of physical and human resources between countries to justify the changing patterns of trade (the so-called "comparative advantage"), others concentrate on the capability for collective action to purposefully alter patterns of trade. The process of economic causation that underlies these two views is the subject of continuing debate.[5]

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[4] See, for example, R.Z. Lawrence, ***Can America Compete***? Brookings Institution, 1984; ***U.S. International Competitiveness: Perception and Reality***, New York Stock Exchange, Office of Economic Research, August 1984; "Industrial Change and Public Policy," The Federal Reserve Bank of Kansas City, August 1983; and R.D. Norton "Industrial Policy and American Renewal," ***Journal of Economic Literature***, March 1986.

Another very important methodological issue concerns the definition of *competitiveness*. The definition given in the previous section is absolute. Competitiveness is measured only by America's ability to achieve certain objectives. Others have approached the issue from the standpoint of our economy's performance relative to our major competitors, as well as to our own past performance, and have found the United States to be competitive. From this relative perspective, American performance is claimed to have been good with respect to: manufacturing employment, capital formation, research and development spending, productivity, and the responsiveness of our economy in shifting from low-growth to high-growth industries.[6]

A final methodological issue is the selection of evidence for assessing competitiveness. There are definite limits on the quality and applicability of the various indicators of economic vitality.[7] These limits are only rarely discussed by advocates of the various policy positions.

Legitimate disagreement also attends the interpretation of the macro-economic evidence of economic decline. As pointed out in the discussion of methodological issues above, for example, some of the phenomena that constitute evidence of absolute competitive decline may at the same time provide evidence of relative economic success. Moreover, some have argued that the causes of any *apparent* deterioration of our international competitiveness have been macro-economic in nature, for example, strong domestic economic growth relative to our major competitors and exchange rate patterns, rather than resulting from weaknesses of particular industries, low productivity, high unit labor costs, trade policies of competitor nations, or other presumed underlying weaknesses.[8]

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[5] Krugman, in ***Industrial Change and Public Policy***, *op. cit.*, pp. 139–153 and "Is Free Trade Passe?", ***Economic Perspective***, Fall 1987; Robert M. Stern, "Testing Trade Theories," in P.B. Kenan (ed), ***International Trade and Finance: Frontiers of Research***, Cambridge University Press, 1976; and Linda Hasselman, "Trends in European Industrial Intervention" ***Cambridge Journal of Economics*** (7) 1983, esp. pp. 204–206.

[6] Lawrence, *op. cit.*, pp 23–25.

[7] For a review of the quality of various economic indicators see ***Supplement to Economic Indicators: Historical and Descriptive Background***, Joint Economic Committee, U.S. Congress, Washington, D.C., 1980; and F.J. Fabbozzi and H.I. Greenfield (eds), ***The Handbook of Economical and Financial Measures***, Dow Jones, 1984.

There is also contention surrounding the appropriate public policy response to industry-specific events. In the first place, it is argued that the process of capitalist economic development is, has always been, and should be, one of continuing rise and fall of industries. Moreover, most *industries* are comprised of intra-sectoral strategic groups that respond quite differently to changing business conditions. While a broadly-defined industry may be experiencing decline, some of its strategic groups may be performing quite competitively. Policy aimed at encouraging *industry* health may discourage the competitive performance or health of intra-industry segments.

Finally, serious doubts have been expressed about our capability to define a reasonable standard through which to foster particular industries. Our capability to successfully pick *winners* and *losers* is believed by many to be inadequate.[9]

C. AREAS OF AGREEMENT

Despite the many disagreements about the nature, scope, and policy implications of American competitiveness, there are many areas of agreement among analysts who seriously have assessed our competitive posture. In this section, the most important of these are discussed. The Department of Defense must act with caution in exercising its influence in such a non-traditional policy area. By focusing its efforts on policy areas where broad agreement exists among experts, the Department can exercise appropriate prudence and at the same time not be paralyzed by disputes about difficult issues and policy choices.

First, most agree that the nature and causes of American competitive positions are very complex. Remedies must be multi-dimensional and probably will yield results only over the long term.

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[8] See, for example, ***The Economic Report of the President***, 1987, pp. 97–123; and J.C. Hilke and P.B. Nelson, ***International Competitiveness and the Trade Deficit***, Federal Trade Commission, May 1987.

[9] See Krugman, "Targeted Industrial Policies: Theory and Evidence," in ***Industrial Change and Public Policy***, *op.cit.*; and C. Schultze, "Industrial Policy: A Dissent" ***Brookings Review***, Fall 1983, pp. 3–12.

Second, most agree that we have a host of policies, laws and regulations — tax laws, monetary policies, antitrust laws, export controls, laws protecting intellectual property rights, congressional appropriations, customs duties — that constitute the environment in which domestic and foreign enterprises conduct business. There is further broad agreement that this de facto *industrial policy* is, at best, incoherent and, at worst, counterproductive. Some effort should be taken to correct this situation to the degree that our political traditions allow.

Third, there is substantial agreement concerning many trade-related issues, including the perception that progress toward free world trade is increasingly threatened by protectionist sentiments and trading practices not regulated by the General Agreement on Tariffs and Trade. There are, of course, major disagreements on what to do about these shared perceptions.

Fourth, there is considerable agreement on the need for increased analytical capability for determining the extent of foreign and domestic Government support for industry and for assessing the inconsistencies in our domestic policies toward industry.

Fifth, there is keen recognition that several sectors of our economy have suffered setbacks in the face of international competition, but that the visibility of these industries has tended to overshadow the vitality of many other sectors from which lessons can be learned.

Sixth, in the areas of education policy, tax policy, research and development policy, and regulatory policy, there is much that is not being done, but that could be done, to improve the quality and flexibility of our nation's pool of human resources and the ability of our industries to compete more effectively in the international marketplace.

Finally, most agree the Department of Defense has a unique responsibility to formulate coherent policies both to foster a reliable defense industrial base and to reduce the cost of its purchases. It is further recognized that the Department has a unique responsibility to mitigate threats to our security posture which arise from distortions of normal patterns of industrial growth and development.

D. SUMMARY AND CONCLUSIONS

The analytical and policy problems that shape the debate on American competitiveness are extremely complex. It is clear that America's economy is in the midst of a period of structural adjustment. This adjustment has spawned an intense economic policy debate about the appropriate response to the changing composition of American industry. The Department of Defense has a stake in the outcome of the debate, both because the overall health of the economy is important to the Defense mission and because of the vexing issues that surround the health of particular industries upon which our defense is dependent.

Our response must have two major thrusts. First, there are broad areas of agreement among policy analysts for the need to develop rational and effective linkages among the practices, regulations, and laws that together define the environment in which our industries operate. Although the Department is not responsible for economic policy, the Department of Defense must do its part to foster and cooperate in such an effort. Second, the Department of Defense must develop a strategy to improve the capabilities of the defense industrial base. Such a capability has two parts. One is the capability to coordinate acquisition policy. This is in itself a difficult political problem requiring the cooperation of the Military Departments and of the Congress. This capability must draw upon recent progress stimulated by the report of the President's Blue Ribbon Commission on Defense Management (the *Packard Commission*), the creation of the position of Under Secretary of Defense (Acquisition), and the Defense Reorganization Act in general. At the same time, the Department of Defense requires a synchronized capability to analyze the structure and performance of *critical industries*; the impacts on these industries of changes in economic policy, acquisition policy, and conditions of international trade; and the development and evaluation of policy instruments aimed at fostering a healthy defense industrial base and contributing to sustainment of a healthy national industrial base.

CHAPTER III
NATIONAL POLICY ISSUES

The United States Government focus on the domestic marketplace generally has emphasized protecting the public against business excesses, rather than also promoting the health of American industries. Nevertheless, the fundamental characteristics of the United States economic system have provided an environment conducive to business success. The freedom to reap the rewards of hard work and innovation has stimulated the creation of enormous wealth, providing American industries with the resources and markets necessary to lead the world in output and technology. In essence, American businesses have not needed Government support to flourish, although these businesses have benefited from research and development funding and purchases tied to Government programs.

While the strengths of the United States economic system have not changed, the market environment for American industries has. The change has been caused by two trends:

- Physical barriers to international trade have been greatly reduced by advances in transportation and communication technologies, causing an evolution from separate national markets to a single, integrated world market;
- Foreign governments have adopted aggressive strategies of economic development, through direct and indirect subsidies to develop and maintain indigenous industries, the promotion of exports, and the creation of import barriers.

United States institutions have not responded adequately or quickly enough to basic shifts in economic and manufacturing power among nations. More recently, American technological leadership also has begun to erode. Effective remedial actions are possible, given the national will to undertake them. However, many of the options available to the nation are beyond the traditional scope of responsibility and authority of the Department of Defense. Nevertheless, these options are critically important to the nation's security, and, in the process of addressing them, a security viewpoint must be considered.

This section summarizes a range of views on the underlying causes of declining American industrial competitiveness, as identified by both Government and private-sector participants in this effort. Not surprisingly, the causes they identified are consistent with those identified in the report of the President's Commission on Industrial Competitiveness and in a great many recent private-sector examinations of the problem.

In this section, causes of the competitiveness problem are grouped into three major categories. The first category addresses management issues. These are particularly sensitive for Government to address without unacceptable intrusions into the private sector. Nevertheless, management is an issue that must be addressed in a continuing public forum on the future economic well-being and security of the United States.

The second category addresses Federal Government policies and practices that directly or indirectly affect the competitiveness of American industry. The third category addresses educational and cultural issues. Education issues might properly be a sub-set of the Government policies category, but are grouped separately because they are long-term and fundamental in nature, and involve Government at all levels, as well as the private sector. This category also addresses national cultural issues, which are broad, common, and inherently difficult to resolve. The Department of Defense has little capability to address or to influence these issues. Even the civil agencies and departments will find these difficult to address. There clearly is a role for the Government, however, beginning with the need to stimulate greater awareness of the problems we face and to build a national consensus to resolve them.

A. MANUFACTURING MANAGEMENT ISSUES

Management issues consistently were identified by participants from industry and academia as the most important causes of declining American industrial competitiveness. There was a general consensus among these participants that American management culture and practices are less effective in the global marketplace than those of foreign firms. Industrial and academic participants in this effort identified numerous specific management practices they considered harmful to American competitiveness.

There are historical reasons for current deficiencies. In the 1950s and 1960s, American industry dominated world manufacturing. American manufacturers could focus on quantity to the neglect of quality. American manufacturers were complacent, while other countries began building powerful new industrial infrastructures and developing superior process technology to manufacture easily-obtained American product designs and technology. Among the results of this period that persist today are many senior managers who continue to view the nature of markets as national, not international, and the nature of product requirements as ***good enough***, not ***world class***.

B. GOVERNMENT POLICIES AND PRACTICES

Many Federal Government policies and practices reduce the competitiveness of American manufacturing companies. These policies and practices tend to be concentrated in the areas of tax, regulation, and antitrust enforcement, but they also range broadly over a number of other areas, including government attitudes toward domestic industry.

Some of America's trading partners have taken an aggressive approach to gaining, maintaining, and expanding market share in the United States, with substantial assistance from their governments. Other governments have helped give key technologies a head start and helped coordinate development, marketing, and pricing approaches by their manufacturers. In addition to aiding their own industries' technological efforts and exports, other governments have also created formidable non–tariff and tariff barriers to imports. The policies of other governments to subsidize and protect their industries are not matched by the United States Government. United States Government policies and actions to *level the playing field* in international trade have been inadequate.

Stronger, more focused efforts are required to create a "level playing field," particularly with respect to manufactured products. For example, United States tax laws should differentiate between *wealth–producing* activities and *wealth–redistributing* activities in treating amortization and depreciation. Productive investment could receive more favorable tax treatment than such activities as stock market speculation. Rare instances of United States Government efforts to foster domestic manufacturing are best characterized as efforts to correct the results of prior neglect, and usually focus on lagging rather than leading industries.

United States Government neglect of industrial competitiveness extends beyond the capital base and industrial technology. Compared with some other governments, the United States Government also has done very little to provide or to stimulate worker training and re–training programs in manufacturing. Limited efforts thus far have emphasized retraining workers from declining industries, and some officials believe that even such limited efforts are best left to the private sector.

The absence of a focal point in the United States Government to analyze comprehensively our policies and practices toward the industrial base in such areas as tax laws, procurement rules, research and development policy, and technology transfer policy seriously limits the Government's ability to evaluate the elements of American competitiveness. In addition, the lack of sufficient knowledge of the potential impact of proposed laws or policies on the industrial base often causes inadvertent but harmful results.

Many congressional and executive intrusions into the market have negative impacts on the competitiveness of American manufacturing industries. The tax code, antitrust laws, and Department of Defense acquisition policies frequently discourage investment in domestic production facilities and innovation by domestic producers. Some elements of United States law, appropriate when the United States was a more self-contained economy, now are harmful to American industry in a global market. Actions to adjust these laws to the conditions of a more international marketplace have been slow and inadequate.

Modern telecommunications and transportation systems have reduced significantly the barriers to international trade by reducing *long-distance* costs. This has enabled producers to compete for market share external to their domestic markets. Other countries, particularly Japan, have taken advantage of this new market environment. American producers, however, have been slow to respond. For example, while total United States investment in research and development is proportionately equivalent to that of Japan, the Japanese do not invest heavily in defense research and development. Consequently, they are able to invest proportionally more in research and development for commercial products and processes. They also invest more in capital equipment. Relative to Japan, American firms are *underinvested*. The Japanese worker reportedly is supported by about $48,000 in capital investment in contrast to about $32,000 for the American worker.

Tax Policies

The absence of incentives in tax law for training of the workforce, investment in new plant, equipment, and process technology, and doubts about continuation of incentives for research and development detract from the ability of American industry to remain competitive. Relative to other industrialized nations, America's tax system provides little or no incentive for long-term investments. Capital gains and earnings on savings and investments are taxed as ordinary income at relatively high rates, while consumption generally is taxed at a low rate, if at all. This stimulates consumption rather than saving, and results in reduced capital for industrial modernization and technological development.

Elimination of tax incentives for domestic investment has reinforced the trend to foreign sourcing and reduced the potentially beneficial effects of a weaker dollar on investment decisions of American firms. A corollary effect of the elimination of investment tax incentives in 1986 is a weakening of the domestic supplier base. These effects of tax law changes may be partially offset in the future by lower tax rates, but the nature and extent of the impact of lower rates on investment decisions are not yet apparent.

The American tax system at all levels of government places a heavy tax burden on American industry (for example: income, property, and labor taxes) but not on equivalent products manufactured elsewhere and sold in the United States. Many countries use a value-added tax to ensure that the products of both domestic and foreign producers are taxed equally and fairly, and, because of the value-added tax, are able to minimize other direct (and unequal) taxes on their domestic industries.

Regulatory Policies

During the decades of the 1960s and 1970s, American requirements for emissions, safety, and environmental controls imposed large *non-productive* costs on American manufacturers at the expense of additional investments in productivity improvements. This broad range of socially desirable laws had, and continues to have, a major impact on manufacturing costs in the United States and, in some industries (forgings, castings, and specialty chemicals), has severely damaged American industries' ability to compete. These controls, as well as the costs of documenting compliance with other requirements, such as equal employment opportunity, are indirect but substantial taxes imposed on the products of American manufacturers but not on foreign products sold in the United States. Similar environmental requirements are now being imposed by some governments elsewhere, but industries in these countries are able to apply American-developed technologies at much lower cost than was incurred by the American industries that were forced to develop the technologies, as well as to implement them.

Product liability laws and court awards are becoming a major issue in the United States. Test and evaluation requirements necessary to protect firms against lawsuits are becoming very costly. The problem is magnified by the tendency of the courts to hold the original manufacturer responsible, even when substandard replacement parts have been used in the product. The impact on American manufacturers is generally much greater because these manufacturers are liable for the products sold to American consumers during the 1960s and 1970s when foreign products had made few inroads into the United States market. In some cases, American firms are forced to raise the prices of new products to enable them to cover the liability costs associated with products 20 or 30 years old.

Antitrust Policies

As American industries increasingly are pitted against foreign government-led consortia, restrictions imposed by the Sherman Antitrust Act, the Robinson-Patman Act, the Clayton Act, and other antitrust laws become increasingly irrelevant and harmful to the international competitiveness of American industry. In particular, antitrust laws and regulations that impede cooperative research and development by American firms in both process and product technology are harmful. Restrictions were eased by the provisions of the National Cooperative Research Act of 1984. But many manufacturers still feel constrained by continuing uncertainty with respect to applications of this body of law, which still creates substantial risks for companies in joint ventures.

Currency Exchange Rates

The high value of the dollar in recent years, relative to our major trading partners' currencies (notably the Japanese yen and West German mark), made American-manufactured goods less competitive in world markets (including in the United States). It also influenced business decisions of American manufacturers — encouraging foreign-sourcing, migration of manufacturing facilities, deferral of American factory or product upgrades, and redeployment of capital out of manufacturing altogether. Exchange rates enabled American firms to purchase products and to invest in facilities overseas at less cost than in the United States. Even with a weaker dollar, it has proven difficult to reverse the trend. However, exports of manufactured products recently have surged and there are preliminary indications of investment decision trends favoring United States facilities rather than foreign.

C. EDUCATIONAL AND CULTURAL ISSUES

The American educational system does not produce the required numbers and skill levels of scientists, engineers, and technicians to support advanced manufacturing needs. Evidence suggests that the manufacturing workforce in some other countries may be better educated and trained than in the United States. For example, Japanese high school graduates appear to be much better educated in math, science, and technology than their American counterparts.

Skill levels of many American high school graduates are not adequate, and firms often must invest in programs to upgrade basic reading and math skills. Such results suggest that a system of high–quality technical schools providing skills in applied mathematics, machining, manufacturing methods and technologies, and fundamentals of technology management could be an effective means of providing highly skilled and motivated workers. Such a system might provide a constructive alternative for students who do not wish to or are unable to pursue a university education.

In large measure, the inability of American managers to achieve results in manufacturing equal to those of Japanese managers in the United States stems from management theory and practice, as taught in American universities (where for example, good management is management by financial control; good managers can manage anything; individual achievement is important, not teamwork; manufacturing is an unimportant function). Engineering schools in American universities also focus inadequately on manufacturing, training engineers for careers in product research and development. Few faculty members have industrial experience or expertise. Emphasis on specialization results in engineering professionals who are ill–equipped to understand total manufacturing systems.

There also is an increasingly severe shortage of adequately trained scientific and engineering students flowing from American universities. American industrial laboratories and graduate schools in science and engineering are heavily populated by citizens of other countries. Almost half of the students in American graduate science and engineering schools are foreign.

Beyond the university level, American industry lacks adequate programs to provide continuing professional education and training to engineers and production workers. Continuing education and training programs in American industrial firms are often weak, ineffective, or non-existent. Stimulation of continuing education and training through tax incentives, Department of Defense contract incentives, and other Government efforts could be highly-productive and cost-effective.

American industrial competitiveness problems also are affected by a number of issues that can accurately be characterized as endemic to the American business culture. Clearly endemic problems, as discussed below, are among the most difficult to address effectively or to resolve. Equally clear, changes can be achieved only through broad national understanding and cooperative efforts.

Fundamental Skills

There is a widely perceived failure of American institutions to instill basic skills in our citizens. The general lack of familiarity with foreign languages and cultures in the United States population detracts from American international competitiveness. In years past, American business had little need to understand foreign markets. The United States economy consumed such a large portion of manufactured goods produced worldwide that foreign markets were not particularly important. Moreover, American goods were so superior to foreign goods that little competition existed for foreign sales. However, these market conditions have long since changed. The United States economy's share of total world consumption has declined substantially, and foreign-made products have equaled or surpassed their American-made counterparts in many instances. American society has been slow to respond to these changes. American products are less competitive in foreign markets because they are rarely designed to appeal to the cultural peculiarities of foreign consumers. American businessmen are at a disadvantage with their foreign competitors in understanding overseas markets and accessing technological advances made in these markets due to a general lack of foreign language skills. Language barriers pose a particularly difficult problem for American firms. Japanese and Europeans need only learn English to compete effectively in the world's largest market, but Americans must learn several languages to be as effective overseas.

There has been too little stimulus for the national effort required to change national attitudes toward work, to improve our educational systems, to emphasize needed skills, and to eliminate Government policies which adversely affect American performance in the world marketplace.

Awareness of the Problem

The absence of a national understanding (and Department of Defense understanding) that a healthy, productive manufacturing base is essential to our security greatly complicates efforts to develop and implement remedial measures. Manufacturing strength is needed to ensure that our armed forces can acquire the best weapons, and in quantities needed, to deter and defeat potential adversaries. Such strength encompasses commercial, as well as military production capacity. Commercial capacity adds the financial strength necessary to support research and development and capital investment and provides production resources that could be converted or diverted to military needs under emergency conditions.

Adversarial Relations

The deeply ingrained adversarial relationships between Government and industry and between management and labor are major causes of declining American industrial competitiveness. The relationship between the Government and industry is characterized by Government constraints on industry behavior intended to protect the public good against profiteering and shoddy performance; and by industry performance *by the numbers* to stay within Government constraints and to document compliance. The relationship between management and labor also is adversarial.

These adversarial relationships undermine industrial efficiency, responsiveness, and technological innovation. This Government–industry relationship forces industry to operate within an extremely restrictive environment and discourages (or even penalizes) innovative behavior. Considerable industry effort is invested in satisfying Government paperwork requirements and responding to Government meddling in the manufacturing process.

The management-labor relationship prevents cooperative efforts to identify and implement innovative processes and tends to hold labor productivity to some minimal standard, actively inhibiting any worker capability or desire to improve. Historical barriers to cooperation between management and labor are only beginning to fall, and at much too slow a rate. There is not yet a pervasive sense of shared interests and objectives for the common good.

Other countries (Japan in particular) are much more effective than the United States in achieving industry/Government/labor cooperation on process and product development, and, through cooperation, are more effective in implementing new ideas to make manufacturing more efficient, responsive, and technologically advanced.

Short-Term Focus

American society, historically, has been action oriented and sharply focused on quick results. The short-term expectations that pervade American society have become a major impediment to the long-term planning necessary to compete effectively with other countries.

The equity market is the major source of capital for American industry, in contrast to Japan, where commercial banks are the principal providers of capital to industry. The American stock market is driven by short-term expectations, whereas Japanese banks historically have supported long-term investment. Short-term pressures in the American stock market are increasingly being exacerbated by large institutional investors, whose managers themselves are evaluated on short-term performance. Many of these are non-profit funds (for example, pension funds) that are free to move quickly in the market without regard for tax consequences, and, therefore, to increase the short-term volatility of the market.

Short-term profit expectation has emerged as an important reason for the relative lack of effectiveness of American technology-based businesses. There is a lack of understanding and acceptance in the investment community and the general public of the need for *decade plans* for technology-based businesses. Financial markets that place a premium on short-term results may penalize a long-term orientation by reduced stock values, forced mergers, or hostile takeovers. Conversely, the Japanese (in particular) and Europeans are oriented more toward long-term results, with increasing success.

Lack of Manufacturing Prestige

The attitude in the United States toward manufacturing and manufacturing technology is somewhat negative. American universities have little to offer in these fields. Even within the manufacturing firm, research and design engineers are perceived to have more prestige than manufacturing engineers. One result is that the manufacturing function does not compete effectively for high-quality personnel. (Conversely, the Japanese have a high regard for manufacturing and are totally committed to innovation in both process and product.) These attitudes (and resultant rewards systems) toward manufacturing careers often prevent the best people from beginning or sustaining careers in manufacturing.

CHAPTER IV
DEFENSE POLICY ISSUES

In seeking more comprehensive information on the health of the defense industrial base, the Department of Defense sought to evaluate whether the overall strength of our industrial base masks any weaknesses in individual defense–critical industries.

The Defense Economic Impact Modeling System and other tools were used to identify defense–critical industries. Critical industries are those in which the majority of the Department of Defense budget is spent, directly and indirectly, as well as industries vital to defense production. Two hundred fifteen individual industries were identified, accounting for about 95 percent of Department of Defense purchases from the manufacturing sector. A series of six indicators was developed and applied to each industry: import share of the domestic market; growth in capacity; growth in shipments; capital expenditures expressed as a ratio to industry shipments; productivity growth; and profitability. Comparisons based on the indicators were then drawn between defense–critical industries and the overall United States manufacturing sector. Finally, a ranking of the critical defense industries based on a composite of all six indicators identified defense–critical industries with the poorest overall performance.

Based on this review, which covers the period from 1980 through 1985, we drew the following conclusions:

- Critical defense industries did no worse than overall manufacturers in maintaining a domestic market share in the face of substantial import growth;
- Critical defense industries did worse than overall manufacturers in terms of adding to productive capacity, with only 41 percent of critical defense industries matching or exceeding the overall manufacturing average growth in productive capacity;
- Three–quarters of critical defense industries achieved worse than average growth in real shipments;
- Sixty–two percent of critical defense industries had lower–than–average capital expenditures in 1980. This adverse trend continued in 1985, when 72 percent had lower–than–average capital expenditures;

- Forty–seven percent of critical defense industries had below–average productivity growth (17 actually had declining productivity);
- Critical defense industries achieved average or above average profitability.

These trends, while not definitive, are disturbing, particularly, with respect to indicators of future productivity and competitiveness.

A. THE DEPARTMENT OF DEFENSE MISSION

The mission of the Department of Defense is to provide for the common defense. Political and strategic realities require this to be accomplished through a worldwide military command structure. At the heart of the deterrent power of the United States military presence is an inventory of sophisticated military equipment and the human resources to manage and operate it. These resources are drawn and replenished, in large part, from the same pool of resources that fuel the general industrial economy.

As we look to the future, two fundamental problems threaten Department of Defense capabilities to maintain a modern inventory of qualitatively superior military equipment. The first is the environment in which the Department of Defense and industry conduct business. The high and rising costs of our major weapon systems appear driven by an acquisition system that encourages long acquisition cycles, high development and production costs, and sometimes obsolete technology. These problems most recently have been addressed by the *Packard Commission*. Some of the recommendations of the Commission have been implemented, others are in the process of being implemented, and others are under active consideration.

Yet, even if all of the Commission's recommendations were adopted and proved to be effective, a second problem would remain: many of the strategic industrial sectors that support the production of modern weapon systems are being threatened by intense, long–term competitive pressures from foreign producers. These include: semiconductors and semiconductor equipment, shipbuilding, automobiles, construction equipment, machine tools, flexible manufacturing systems, ball and roller bearings, castings, forgings, steel, and ceramics, to list a few.[1]

We do not know with any degree of certainty how these developments ultimately will affect our national security. We do know that they give cause for concern. Our capacity to build or replace critical force structures independently of economic and political decisions of other sovereign powers is essential to our security. The Department of Defense, therefore, must ensure that its actions and policies (especially, but not exclusively, in the acquisition arena), as well as the actions and policies of other government institutions, do not weaken our manufacturing sector and thereby degrade our defense posture.

Department of Defense action must be sensitive to the general economic health of the nation. The Department's concern for the health of the manufacturing sector and for individual industries within that sector should not be construed as an endorsement of sectoral policies for the economy as a whole. On the other hand, the Department's competitiveness initiative has identified a number of national policy initiatives aimed at bolstering the general health of the manufacturing sector, and it is appropriate for the Department to provide a security perspective to influence actions by the appropriate agencies.

Neither the nation nor the Department of Defense can afford polices which do nothing but protect failing industries or firms. Not only would these aggravate the weapon systems cost-growth problems identified by the *Packard Commission*, but, in the absence of counteracting incentives, such protection would undermine the competitiveness that this Department of Defense initiative aims to achieve. Protectionism also would be a threat to cooperative production agreements with our allies. The United States has encouraged a *two-way street* in military trade with our allies primarily as a means of balancing the costs of military alliances. The abrogation of such agreements by domestic interests may result in higher costs, reduced competitiveness, loss of interoperability, and, to this extent, should continue to be discouraged.

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[1] ***U.S. Industrial Base Dependence/Vulnerability,*** Roderick L. Vawter, National Defense University, December 1986. Our sense of the term "strategic industry" is discussed in chapter II of this report.

B. SECURITY CONCERNS

From one perspective, there are at least four reasons why the Department of Defense is, and should be, concerned about the overall competitive health of the United States manufacturing base.

First, the Department has a direct responsibility toward the sectors of the economy that constitute the defense industrial base. In many of the transactions between the Department and the industries that produce the instruments of military deterrence, the influences of Government procurement regulations and a single-buyer market structure have created a unique business environment. The Department of Defense must pay close attention to how its policies (and the policies of other Government agencies and institutions) affect this business environment and the extent to which the ultimate objectives of assuring our security are served by this environment.

Second, the vitality of our manufacturing economy in general ultimately determines the war-fighting power of our nation's force structure. The economy's latent capability to enhance current forces in response to strategic threats is a critical element of our deterrence strategy.

Third, the Department of Defense is cognizant of its formative influence on the larger manufacturing economy. Through its impact on the employment of scientists, engineers, and factory workers, its research and development expenditures (particularly in advanced manufacturing technologies), and its role in fostering capital investment, the Department's influence on innovation and manufacturing far exceeds its relatively small share of expenditures in our national income accounts.

Finally, the weapon systems for our nation's defense are purchased, in the long-run, from revenues generated by a healthy and growing economy. Such economic growth has allowed the nation to pay for its defense. For many years, the cost of our worldwide security obligations has been less than seven percent of our gross national product.

C. DEPARTMENT OF DEFENSE CONCERNS

The report of the Defense Science Board Task Force on Defense Semiconductor Dependency published in February 1987 was directed specifically at the semiconductor problem, but many of its findings and conclusions are equally applicable to other lower-tier industries that, collectively, provide the technological backbone of advanced weapon systems.

Competitive pressures, particularly from Japan and the newly emerging, economically competitive countries of Asia — Taiwan, Hong Kong, Singapore, and Korea — as well as Western Europe, are contributing to the relative decline of industries that are important to America's defense. As in the semiconductor case, the Department of Defense is the buyer of relatively small portions of these industries' total output, but, nevertheless, is absolutely dependent on these industries for its weapon systems. In most of these industries, volume production for commercial markets is essential to controlling unit costs and maintaining world class standards of quality.

As the commercial base has eroded, technology leadership also has moved, or is moving, offshore because technology leadership is dependent on the commercial base for revenues to support research, development, and investment. Thus, while the Department of Defense has no direct responsibility for ensuring the vitality of commercial manufacturing in the United States, it is unable to meet its mission requirements effectively without a broadly capable industrial base.

In a growing number of industry segments, if current trends continue, the Department of Defense will be dependent on foreign-sourced hardware and technology in the acquisition of the technologically superior weapon systems that are fundamental to our strategy of offsetting numerical inferiority with technological superiority. Specific elements of Department of Defense concerns are discussed in the remaining paragraphs of this section.

Technology Leadership

There is a substantial body of evidence that technological leadership is irrevocably tied to manufacturing capacity and leadership. The revenues generated by successful manufacturing are essential to achieving and maintaining the levels of research and development required for technological leadership. Without technological leadership, the Department of Defense cannot count on industry's ability to produce affordable, high-quality, state-of-the-art weapon systems. In many industry sectors that are key to defense production, the manufacturing base has declined, and as a result the Department of Defense (and the United States generally) is now beginning to experience the reality of declining technological leadership.

Foreign Ownership of American Manufacturing Facilities

The issue of foreign ownership of American manufacturing facilities has not received adequate attention. The most common view is that the rapidly increasing level of foreign ownership is beneficial to the United States. In this view, such investment reduces the magnitude of the trade deficit, provides jobs for Americans, and increases domestic tax revenues. This view overlooks economic issues such as the long-term impact on the current account of a continuing flow from the United States of repatriated profits and other fees. More importantly, it overlooks the fact that ownership tends to dictate the geographic location of the underlying technologies. Security concerns are not resolved by domestic manufacturing facilities that are dependent on technologies controlled by other nations.

Manufacturing Technologies

Particularly devastating in the long-term is the loss of key production technologies and equipment. In some vitally important technologies, the battle may already have been lost.

Numerically-controlled and computer numerically-controlled machine tools (developed in the United States with Department of Defense funds) represent one such critical technology where the lead already has shifted. The fact of lost leadership is reflected in procurements by American manufacturers of advanced machine tools from Europe and Japan. Cost is often quoted as a determining factor in the decision to buy foreign tools. Delivery terms are another factor. But the decision is most often made on the basis of quality and advanced features.

Electronics manufacturing equipment is another example of this destructive trend. American semiconductor manufacturers, increasingly hard-pressed by foreign competitors, have survival as their primary goal. In many categories of semiconductor manufacturing equipment, the technological lead clearly has passed to other nations, primarily Japan, and American semiconductor manufacturers are buying Japanese manufacturing equipment because it is the best available.

This is but the leading edge of scores of technologies where other nations are developing the most advanced manufacturing technologies for the most advanced products. Such loss of supremacy in manufacturing technologies is a particularly insidious threat to American technological and manufacturing leadership. As long as foreign state-of-the-art manufacturing equipment continues to be commercially available to American manufacturers (and they elect to purchase it), the decline of equivalent American equipment industries barely is noticed until an evolutionary process reaches crisis proportions.

The decline of manufacturing equipment industries is of particular concern to the Department of Defense. As long as state-of-the-art production equipment is manufactured in the United States, there is a substantial capability to reconstitute or expand American product industries. However, without the basic tools for manufacturing, this capability virtually disappears, leaving United States security vulnerable to the political and economic processes of other nations.

Foreign Dependencies

Foreign sourcing of key parts, components, and complete products is an extensive and growing business practice in both commercial and defense manufacturing. Foreign sourcing may evolve over time into foreign dependencies. Potential foreign dependencies are areas of concern. While this issue has been studied extensively on an *ad hoc* basis, and anecdotal evidence abounds, there are few, even moderately comprehensive studies of foreign-sourced components of key weapon systems.

The potential for divergent political or economic interests to disrupt the free flow of the most advanced technologies and products has never been addressed adequately in the few, limited American assessments of foreign dependencies. There was, perhaps, no need for such assessments when the United States was the world leader in virtually all militarily critical technologies. This clearly is not the case today. Sole source dependencies on foreign technologies for essential weapon systems components are inherently risky.

D. UNDERLYING CAUSES OF COMPETITIVENESS PROBLEMS IN THE DEFENSE INDUSTRIAL BASE

This section presents brief summaries of Department of Defense-related causes of problems in the defense industrial base. With one exception, the order of presentation is not intended to imply priority or relative importance. The exception, which is considered to be fundamental to further progress in improving the competitiveness of American defense manufacturing industries, is the necessity to establish permanent organizational structures within the Department dedicated to manufacturing excellence.

Program and Budget Instability

Constant budget turbulence, which makes effective long-term planning impossible, and frequent changes in the *rules of the game* (competition requirements, profitability, audit standards, etc.) are major impediments to achieving efficient manufacturing operations. These problems are aggravated by small volume procurements, year-to-year program uncertainties, and program stretch-outs that contribute to an environment in which Department of Defense contractors are unwilling to invest in systems for productivity or quality improvements. The rate of return on such investments is not only low, but uncertain as well. (It should be noted that after-the-fact estimates of the profits of defense firms are contested. The findings of the last major review of profits, the Defense Financial and Investment Review (DFAIR), a 1985 Department of Defense study, are contested by the United States General Accounting Office. The study also has been characterized by a major investment banking firm as "less than carefully conducted.") Despite the lack of precise data, participants in this current effort believe that defense business traditionally has earned a low rate of profit; but that other factors, such as cash flow and certainty of return, have compensated for this. Recent changes are reducing or eliminating these incentives as well. This is particularly damaging in the case of diversified companies or electronics subcontractors, who can — and do — disinvest from defense.

Competition, as currently practiced by the Department of Defense, adds another reason for contractors not to invest in product or process research and development because of the likelihood that the Government will require the results of their investment to be transferred to competitors.

Absence of Market Incentives

The absence of normal market incentives in Department of Defense procurements is a barrier to efficient operations. Unit cost reductions, quality improvements, shortened delivery times, etc., do not stimulate demand for additional units or provide greater market share, nor do unit cost reductions result in increased profit (more often, the reverse is true). Increased investment in plant, equipment, training, etc., has no direct bearing on future contracts. A superior product or manufacturing process will not yield either higher profits or improved market share. The absence of such normal market incentives and rewards is compensated for by massive government efforts to prescribe substitute control mechanisms, which are themselves barriers to improvement.

Department of Defense Procurement Policies

In the very forthright views of the experts we consulted, Department of Defense procurement policies and regulations contain many characteristics which inhibit achievement of manufacturing excellence, including:

- Emphasis on price, which forces short cuts and reduces incentives for investments in new equipment and quality systems;
- Evaluation criteria focused totally on product performance, at the expense of producibility and reliability;
- Emphasis on forcing contractors to fund (and assume risk for) program specific tooling, test equipment, etc.;
- The absence of risk–sharing for innovation;
- Emphasis on low acquisition cost and schedule compliance, to the virtual exclusion of low life cycle cost (quality, maintainability, ease of use);

- Intense pressure on profits—down to levels that virtually guarantee the contractor will have very limited ability to invest in future productivity programs.

Department of Defense Organization for Acquisition Management

The manner in which the Department of Defense is organized to manage acquisition is a barrier to efficient manufacturing: functional segmentation (for example, between the procuring contracting officer, administrative contracting officer, plant representatives, Defense Contract Administration Service, Defense Contract Audit Agency, etc.) causes contractors to organize reactively (and defensively) along similar lines, to the detriment of efficient operations.

The organizational problem was exacerbated by lack of discipline in the system. Practices vary significantly from one procurement office to another and from one Military Department to another. Different Government agencies (Defense Contract Administration Service, Air Force Contract Management Division, National Aeronautics and Space Administration, etc.) assigned surveillance responsibilities over multi-divisional companies apply agency/Military Department unique rules, regulations, procedures, etc., with extremely adverse impact on company efficiency and costs. Requirements and procedures are also inconsistent from one type of procurement to another. Different rules apply for production spares and replenishment spares. Primes are required to test purchased components, but the Department of Defense does not test the same components when it buys them directly from the supplier.

Emphasis on Competition

Since the inception of offices of competition advocates in each of the Military Departments and competition advocates in all major buying commands, the Department of Defense has emphasized competition on the basis of initial production price, sometimes virtually ignoring contractors' capabilities and records for quality and timely performance, as well as down-stream (life cycle) costs. Frequently, price competition does not provide the best value to the Government. Emphasis, under the Competition in Contracting Act, on low-cost bidders favors companies who bid fully depreciated equipment and hurts those with modern facilities. The emphasis should shift to quality and responsiveness.

Product and Process Specification

The Department's heavy reliance upon process and production specifications is frequently counterproductive. Components are required to be manufactured by processes and to standards which are not state-of-the-art and which do not provide the best product at the best price. The manufacturer, who has the greatest expertise, has little voice in component design or manufacturing processes.

Lack of consistency and uniformity in product and process specifications among various Government agencies also has adverse impact on contractor operations and costs (for example, there have even been instances where occupational safety and health requirements prohibit manufacturing to Department of Defense specifications).

Life Cycle Costing

Logistic support analysis requirements included in many contracts provide the information required for effective life cycle costing (human resources and training requirements, support equipment requirements, spare parts requirements, etc.), but Government personnel rarely use the data effectively. Most Department of Defense contracting officers focus totally on acquisition cost and pay little attention to the concept of total life cycle costing.

Life cycle costs are inherently less certain than acquisition costs, and Government decisionmakers are less willing to assume the risk of relying on life-cycle projections. The Department has no adequate means to monitor and evaluate actual versus projected life cycle costs (and, hence, no means to gain additional confidence in evaluating contractors' projected life cycle costs).

Subcontractors and Suppliers

The Department of Defense procurement processes are focused on prime contractors, even though purchased materials and components supplied by subcontractors represent 50 to 85 percent of the total cost. The Department does not require or encourage vendors' participation in strategic planning decisions or design processes. In fact, requirements of the competition advocates for *free and open* price competition for subcontractors and suppliers have the effect of keeping the supplier base in constant turmoil and make it virtually impossible for defense contractors to build a stable base of reliable, high quality, cost-effective vendors. This is the opposite of the practice generally credited for the high quality of Japanese products.

Emphasis on price competition by the Congress and the Department of Defense effectively precludes the development of long-term relationships between prime contractors and suppliers and stimulates an adversarial relationship between them. The absence of long-term relationships does not permit extended, cooperative design, development, and manufacturing exchanges between the primes and suppliers. Little or no emphasis is placed on value analysis or value engineering by suppliers or their primes.

Annual price competitions are weakened by the refusal of many of the best-qualified suppliers to participate due to their reluctance to become involved in complex, expensive, and non-productive Government rules and regulations. Many desirable, highly-qualified suppliers refuse to do business with defense prime contractors because of the sheer weight of compliance with the body of laws, regulations, rules, and procedures that primes are required to pass through from the Government to them. This narrows the range of potential suppliers and reduces competition.

From the prime contractors' point of view, the flow-down requirements for subcontracts are virtually impossible to administer on the limited margin allowed by the Department of Defense. Small and disadvantaged business set-aside requirements imposed on defense prime contractors (together with excessive requirements for record-keeping and reporting and multiple, uncoordinated compliance reviews) further increase the administrative costs of doing business with the Department of Defense and may result in the lower quality and/or higher cost of purchased components.

Contract Administration

Multiple layers and large numbers of Government overseers, inspectors, and auditors (Army/Navy/Air Force plant representative offices, the Defense Contract Administration Service, administrative contracting offices, the Defense Contract Audit Agency, etc.), many of whom are resident in contractors' facilities, add significantly to the costs of doing business with the Department of Defense.

One result of the Government's heavy emphasis on oversight activities is that management focuses its attention more on passing audits and inspections than on improving quality and productivity. Many defense contractors believe that the Government's practice of imposing layer–upon–layer of quality inspectors and after–the–fact quality controls actually inhibits the development of modern systems such as statistical process control and other effective quality systems.

Management Issues

For firms in the defense industrial base, factors other than engineering excellence, innovation, and product quality often determine success or failure. These include their political constituency and the effectiveness of Washington lobbying efforts (both of which tend to restrict competition). Even management skills must be different. The need to have detailed knowledge of the *ins and outs* of the procurement process, the patience to deal with the process, and large and capable staffs of *documenters* to comply with reporting/compliance requirements imposed by the Department of Defense and Congress all are skills virtually unknown outside defense business.

For defense contractors, as compared with commercial manufacturers, management has a much smaller impact because of the degree to which contractors' operations are controlled and limited by the Department and the Congress. Micromanagement of defense programs and budgets and of contractor operations, a strong tendency to legislate broad remedies in response to isolated *horror stories*, and continuing use of defense procurements as instruments of social policy all are examples of Departmental and congressional activities that significantly add to the Department's costs and impede efficient, professional procurement efforts.

Many defense contractors feel that modern manufacturing management techniques (just–in–time inventory control, statistical process control, etc.) do not apply to them because of limitations imposed by Department of Defense rules, regulations and practices. For example, a large bureaucracy dedicated to *inspecting in* quality severely restricts contractors' incentives and ability to apply statistical process controls to *build in* quality.

It is difficult, to use another example, for a defense contractor to establish a research and development strategy, and difficult to measure its effectiveness. Research and development productivity in the private sector is controlled by strategic planning, resource allocation, and corporate culture. In defense industry, contractors have little control over the first two factors (which are largely controlled by Government budget decisions and regulations).

Emphasis on meeting specifications also reduces incentives for quality and innovation. Non–defense companies tend to be more efficient and innovative, not because their people are better, but because they are free of the restrictions imposed by the Congress and the Department of Defense.

CHAPTER V
BOLSTERING INDUSTRIAL COMPETITIVENESS

The several hundreds of Government and private sector experts who contributed to this effort were extremely forthright — frequently even harsh — in their assessments of the problems in our manufacturing base attributable to private sector managers, Government policies, and most notably, Department of Defense policies and practices. We seriously have evaluated their contributions and have attempted to report those assessments faithfully and act upon them effectively.

Over the course of this effort, we determined that a significant number of required improvements are possible within the existing authority of the Department. In fact, we identified numerous ongoing Departmental programs and recent initiatives to improve manufacturing operations in the defense industrial base. These include a number of actions that relate directly to the conclusions and recommendations of this report.

There are other recommended actions that primarily are directed to the Department of Defense, but will require coordination with the Congress and other departments and agencies of the Executive Branch. Finally, there are recommendations for action by the Government that clearly are beyond the scope of Department of Defense responsibility and authority. For these, the Department of Defense urges prompt consideration by the appropriate authorities.

CONCLUSIONS AND RECOMMENDATIONS

The remaining portion of this section contains 19 conclusions and recommendations for action by the Department of Defense and other Government departments and agencies. The order of presentation generally corresponds with our six major thrusts: (1) forging the right relations with industry; (2) improving the acquisition system; (3) establishing defense industrial strategic plans that support our military strategic plans; (4) developing manufacturing capabilities concurrent with the development of weapon systems; (5) laying the foundation now for the technical skill base required for tomorrow's defense needs ; and (6) ensuring that industrial base issues important to our defense benefit from the full spectrum of potential policy remedies, when appropriate.

Forging the Right Relations With Industry

Conclusion

The Department of Defense ability to meet the materiel needs of our security objectives relies on the private sector and is being impeded by an exaggerated adversarial relationship. Lack of trust on both sides, perhaps fully justified, creates an environment in which significant improvements are increasingly difficult.

Discussion

Regardless of the source of distrust, there is a powerful need to build a cooperative relationship between the Department of Defense and industry that will lower barriers to improvements, enable more effective policy development and implementation, and contribute to the national goal of a strong industrial base.

This could be accomplished by creating a mechanism that would contribute to better understanding and consistency of effort by enabling senior industry managers (while avoiding any possible conflict of interest) to participate in the analysis of priority issues and alternative solutions.

Two bodies, a Manufacturing Advisory Council and a Defense Manufacturing Board might function in similar ways, but in different environments. The Manufacturing Advisory Council's activities would be focused on public policy issues and national economic issues relating to manufacturing, and would provide the Department an essential linkage to civilian issues, programs, and policy options in these areas.

The Defense Manufacturing Board would be established within the Department as a permanent entity, with a permanently assigned secretariat, or staff. Its functions would be keyed directly to defense manufacturing issues and problems. A key function would be to provide visibility to manufacturing and industrial base issues within the Department of Defense.

Recommendation

The Department of Defense should immediately begin to establish a non-adversarial means of communication between industry and the senior policymakers of the Department. Potential means to this end include establishment of:

a. A Manufacturing Advisory Council, sponsored by the National Academy of Sciences, an objective third party, and;

b. A Defense Manufacturing Board, an internal organization (modeled, perhaps, after the Defense Science Board).

Strategic Planning Task Force

Conclusion

The implicit strategy of the Department of Defense for addressing industrial base issues has been to conduct ad hoc studies of current problems. While individually important and useful, they have not been sufficient to resolve problems stemming from occasionally conflicting regulations, laws and directives, and inconsistent attention and resources dedicated to industrial base issues. The result has been insufficient resource allocations, confusion and lack of effectiveness in solving industrial base problems.

Discussion

A coherent, effective organization is required now to coordinate and provide oversight of ongoing industrial base initiatives and, more importantly, to do the necessary planning and organization work required to establish permanent institutional mechanisms.

Recommendation

The Department of Defense should ensure a viable industrial infrastructure is maintained to provide military materiel in the quantity and quality required during peacetime and for emergencies. Specifically, the Department should develop industrial strategic plans explicitly linked to military operational plans. The goal should be to identify and address actual and potential shortfalls systematically through mechanisms that sort out the relative urgency and importance of technological and industrial requirements against a backdrop of military planning scenarios and objectives. The Department should provide for a continuing assessment of both the short and long-term defense industrial base capabilities along with a clear ennunciation to industry of what is needed from the industrial base and when.

The Department of Defense should immediately establish a task force under the direction of the Under Secretary of Defense (Acquisition), staffed with specialists from the Office of the Secretary of Defense, the Military Departments, and the Organization of the

Joint Chiefs of Staff, to expedite implementation throughout the Department of these and other actions identified in the report. Among other things, the task force should:

1. Develop and staff a Departmental policy statement regarding defense industrial strategic planning in support of military operational plans.

2. Determine the organizational structure, staffing and budget necessary to institutionalize the defense industrial strategic planning function in support of military operational plans.

3. Establish senior level liaison with selected allies, American industry, and appropriate civil agencies such as the Departments of Treasury, State and Commerce.

Production Base Advocate

Conclusion

The system that has been erected over decades by both the Department of Defense and the Congress to obtain the materiel necessary for our security could be improved to accomplish more effectively the objectives of providing the military with appropriate technologies, within reasonable time periods, at reasonable cost, and of yielding outstanding quality products that can be produced in time and in the necessary quantities to satisfy potential emergencies.

Discussion

The laws and regulations under which Defense acquisition programs function are, by any measure, a *hodge-podge* which has evolved over several decades. A substantial portion of the entire body of rules was put in place in response to specific occurrences of poor management or wrong doing, and is intended solely to ensure that these occurrences *can never happen again*. Typically, such remedial actions initially were not evaluated for soundness and feasibility of implementation, nor have they been subsequently evaluated. There is a compelling need for institutional means, such as a Production Base Advocate, to test objectively the soundness and impact on industrial efficiency of existing and proposed laws and regulations, as well as the means to develop and test innovative alternatives to such laws and regulations.

Key characteristics of the office of Production Base Advocate should include:

- A small, but highly qualified staff, headed by the Department's Production Base Advocate. Other staff members would be drawn from the Military Departments and Defense Agencies, in the same manner as for other joint program offices;
- Annual budget authority to support tests of innovative manufacturing and industrial base programs;
- A board of advisors, with membership from industry, academia, and other Government organizations (the Manufacturing Advisory Council and/or the Defense Manufacturing Board could fulfill this function).

The Production Base Advocate should have broad authority to deviate from acquisition regulations (both legislative and administrative based) in the process of conducting experimental programs to improve Department of Defense management.

Recommendation

The Department of Defense should establish an office of Production Base Advocate, an institutional structure to receive, evaluate, and test innovative ideas for improvement of Department of Defense manufacturing programs.

Analytic Capability to Develop Defense Perspectives

Conclusion

The Department of Defense has not had adequate institutional mechanisms for maintaining awareness of either technology or industry trends, nor for understanding, analyzing, or assessing the national and international issues that surround the questions of American technological or industrial competitiveness.

Discussion

In order to guide defense policy more effectively, the Secretary of Defense and the Under Secretary of Defense (Acquisition) require coherent, dedicated data acquisition and analysis support not currently available to them. In developing this capability, the Department should recognize existing programs which might be adapted to address this shortfall. Two such programs, the Defense Industrial Network and Project SOCRATES, that are now in their formative stages, are being established to deal with specific problem areas in manufacturing and technology, but might economically be adapted to fill this need.

Recommendation

The Department of Defense should establish permanent, institutional mechanisms to acquire, analyze, and assess manufacturing and technology data and provide the principal officers of the Department cogent, objective advice with respect to defense issues that involve the performance of the United States industrial base. The Defense Industrial Network and the Defense Intelligence Agency's Project SOCRATES should be merged and adapted to fill this requirement for data.

Foreign Dependencies

Conclusion

From the national security perspective, foreign dependencies in technologies essential to defense production are inherently risky, and minimizing them should be a Department of Defense and national priority. However, there is at present no reliable system even to identify such dependencies, not to mention systems to minimize them. Especially in critical lower-tier industries which support defense prime contractors, visibility is key to maintaining the ability to assess the consequences of foreign-sourcing and evaluate the implications of the potential loss of leadership in key technologies.

Discussion

The Department of Defense does not know the extent to which foreign-sourced parts and components are incorporated in the systems it acquires. There is no systematic, established means to identify foreign-sourced parts and components and, hence, no way to determine the extent of foreign dependencies or vulnerabilities. There have been a number of *ad hoc* efforts that have identified specific foreign dependencies and preliminary indications that foreign dependencies are increasing. In a national emergency, the consequences of extensive dependence on foreign sources could be extreme.

More immediately, however, an apparent consequence is that we are experiencing the loss of technological leadership in key manufacturing technologies at an increasing rate. This has extremely adverse potential for our long-term security interests.

Recommendation

The Department of Defense should develop and implement systems to provide visibility of critical foreign-sourced items in or proposed to be in new weapon systems, prior to the demonstration/validation decision milestone during the acquisition decision making process.

Program Stability

Conclusion

There is little doubt that program and process instability and uncertainty are extremely detrimental to defense acquisition and manufacturing management. Much of the instability and uncertainty clearly is attributable to lengthy budget and program decision processes within the Executive Branch. Equally clear, much of it is attributable to congressional micromanagement, not just of defense programs, but of small details of the acquisition management process. It is unlikely that major improvements in defense acquisition and manufacturing management will be achieved in the absence of greater predictability, stability, and certainty in programs and the acquisition process.

Discussion

Both Congress and the Department of Defense contribute to an environment which is inimical to good manufacturing practices and cost containment, and which is a strong impediment to investment by defense contractors. Elements of the environment include constant budget turbulence, small-volume programs, year-to-year program uncertainties, program *stretch outs*, changes in the rules of contracting (competition, military requirements, allowable profits, audit standards, etc.), late appropriations, and uncertain congressional continuing resolutions. These great uncertainties by themselves are sufficient to motivate defense contractors not to invest in productivity improvements. They also serve as strong impediments to highly qualified commercial manufacturing firms entering the defense market; and in some cases, they have been primary causes of firms leaving the defense market.

Recommendation

The Department of Defense must support and make better and more extensive use of programs already available (or potentially available) to stabilize major acquisition programs. These include two-year budget cycles, multi-year contracts, and a more realistic (achievable) five-year program. There also must be incisive analyses of programmed and budgeted development and production rates specifically focused on the issues of manufacturing efficiency and cost, contractor incentives for investment, and long-term impact on industrial capacity and capability.

Life Cycle Costs

Conclusion

The most effective measure of the value of a weapon system is based not on its initial acquisition cost, but on the total costs over its entire fielded life. Effective, universal use of true life cycle costing techniques is an imperative if the Department of Defense is to acquire the most effective and reliable systems at affordable overall costs.

Discussion

The concept of life cycle costing provides the most sound basis for effective evaluation of proposed weapon system research and development and production programs. However, life cycle costing is not often used effectively in the evaluation and source selection processes. Program managers and source selection teams often focus overwhelmingly on up–front costs and schedule considerations in evaluating proposals. Budget pressures are an obvious cause of these priorities, but there are other, perhaps equally important, causes.

Department of Defense personnel are uncomfortable with the inherently uncertain down–stream costs implied in the issues of how reliable a system is and how easily it can be maintained and used, as they are reflected in contractors' projections of requirements for human resources and training, support equipment, spare parts, etc. Even after the fact, the Department has no adequate means to monitor and evaluate actual versus projected life cycle costs and, hence, has no means to gain added confidence in future evaluations of contractors' projections of life cycle costs. One consequence is that the Department of Defense rarely assigns any weight to contractors' reputations for producing reliable, high–quality, low–maintenance systems, because it has little ability to do so.

Recommendation

The Department of Defense should raise the priority of using life cycle costs as a basic evaluation technique in acquisition programs. An assessment should be made of the progress of the Department of Defense in applying this concept. More research should be conducted to achieve a better understanding of the concept and how it can be exploited for the Department's benefit. Specific procurement experiments should be conducted to explore how the use of life cycle costing can be developed to reduce overall costs of weapon systems.

Emphasis on Process Technology

Conclusion

American manufacturers, in many cases, are unable to get products from research and development into the market as fast as is necessary to be competitive. There are many examples where American manufacturers are unable to develop and apply new process technology in their operations as fast as their international competitors. In the defense sector, the Department of Defense Manufacturing Technology Program is the only existing program focused specifically on development of advanced manufacturing process technology.

Discussion

The Department of Defense Manufacturing Technology Program has contributed greatly to the advancement of generic manufacturing science and technology, but even more productive results could be achieved with greatly expanded and more predictable levels of resources. The Department of Defense also must find specific means to integrate concurrent product and process technology development into research and development programs and the acquisition life cycle. One way would be to require concurrent development of efficient, cost effective manufacturing capability as part of all research and development efforts. Among the measures that could be pursued is a contract clause tailored to each research and development effort to require development and demonstration of the ability to produce the product.

Recommendation

The Department of Defense should develop a comprehensive program to ensure development and application of effective, advanced process technologies concurrent with basic science and technology programs and weapon systems development programs. The program should have four major thrusts: (1) development of manufacturing technology as part of all basic science and technology programs; (2) development of manufacturing technology in all weapon systems development programs; (3) changes in policies governing contractor independent research and development/bid and proposal costs to stimulate emphasis on manufacturing technology and, (4) greatly expanded emphasis and resources for the Manufacturing Technology Program.

Technological Skill Base

Conclusion

The quality of the nation's technological skill base is an indicator of the future prospects for American industrial competitiveness. The source of the technical skill base is our university system. While the quality of the system is sound (and it remains a national competitive advantage when compared to the rest of the world), there are some areas of concern.

Discussion

Much of the discussion about technical education focuses on funding, but the issue is equally one of national leadership. The nation must build its technological skill base if it is to achieve the goals of security and well being of its citizens. Current data suggests that foreigners may be utilizing our graduate technical programs more than we are (85 percent of the recent growth in graduate education has been from foreign students often on state subsidy and/or Federal Government grants). Coupled with demographics that will reduce the pool of potential scientists and engineers, there is a growing problem that can be altered only by national leadership.

The effort should include all Federal agencies with technical missions, including the National Aeronautics and Space Administration, the Department of Energy, and the National Bureau of Standards of the Department of Commerce. National political and business leaders should be involved with a multi-media approach to achieve a national consensus for support. Industry should be stimulated to assist with the effort in local and regional programs, seminars, cooperative education efforts, and, particularly, with attractive technical career path opportunities.

Recommendation

The Department of Defense should lead the organization of a national program to stimulate enrollment in both undergraduate and graduate technical programs to assure both the quantity and quality of technically qualified graduates necessary for national success. A specific objective should be to raise the prestige and attractiveness of technical careers, with particular emphasis on manufacturing.

Incentives for Technical Education

Conclusion

The Department of Defense, perhaps more than any other agency, depends on technology as its lifeblood. The Department has a direct stake in the quantity and quality of science and engineering graduates. Efforts must be made to reverse the decline in numbers and capabilities of technically educated personnel.

Discussion

The Department of Defense might offer scholarships at schools willing to build world–class manufacturing engineering programs. Selection of the schools would be based upon:

- Industrial commitment to maintain leading edge university expertise;
- Industrially supported faculty positions to enable the world's best manufacturing managers to teach future generations;
- Industrial hiring programs to assure that the finest career opportunities are afforded the new generation manufacturing manager;
- State and university commitments for faculty and curriculum development to ensure America remains on the leading edge of the development and management of technological progress.

Recommendation

The Department of Defense should combine a scholarship program in manufacturing engineering with a plan to build university expertise in manufacturing. The program should be developed jointly with industry.

Educational Facilities

Conclusion

State-of-the-art education facilities represent another deficiency in American universities for teaching manufacturing-related science and engineering skills and, hence, provide another impediment for students and faculty alike to pursue manufacturing careers.

Discussion

An instrumented factory program might competitively award grants for a number of advanced manufacturing technology demonstration centers to universities or non-profit coalitions of manufacturers, equipment suppliers, material suppliers, and other appropriate organizations. Each center would consist of an instrumented factory that produces limited quantities of military items, using the latest available state-of-the-art manufacturing technologies. The program would provide for conducting Government-funded research and development associated with the processes used in the factory, encompassing the physical, data, control, and human factors. Mechanisms would be required to ensure that the technologies are promptly implemented in private companies.

Recommendation

The Department of Defense could provide seed money for an instrumented factory program for industries where there are large numbers of companies and significant non-defense applications.

Production Base Impact Assessment

Conclusion

There is a need for focused, coherent analysis of issues affecting American manufacturing industries.

Discussion

United States law and policy historically have been developed primarily in response to domestic requirements, with little attention given to the possible harmful effects they may have on the health, vitality, and long-term survival of American manufacturing industries in an increasingly competitive international environment. Explicit assessments of the effects of legislation and regulation on the health and vitality of our production base should be conducted prior to their promulgation.

Recommendation

The Department of Defense recommends establishing a substantial analytic capability within the Legislative Branch dedicated exclusively to objective analysis of the impact of existing and proposed legislation on the United States manufacturing base and its ability to compete internationally.

Coherent Tax Policies

Conclusion

Direct, indirect, and hidden taxes on the United States manufacturing base are, by current world standards, not conducive to investing at the required levels to achieve and sustain world leadership in advanced technologies and manufacturing processes.

Discussion

Efforts to achieve equitable tax policies domestically have resulted in a substantial shifting of tax burdens from individuals to industry. Especially troublesome to many American manufacturing firms is the fact that the tax burden on industry is fully reflected in the costs of domestically manufactured products, but not in the costs of foreign-manufactured products sold in the American market, even though alternative tax structures to equalize the tax burden across all products are permitted under the General Agreement on Tariffs and Trade.

Recommendation

The Department of Defense advocates and supports the concept that there should be a comprehensive analysis of tax policies specifically focused on enhancing the international competitiveness of American manufacturing industries. The Department of Defense recommends that the President and the Congress jointly cause this comprehensive analysis to be undertaken as a national priority.

Coherent Trade and Domestic Policies

Conclusion

Many other elements of Federal law (antitrust, environment, safety, etc.), other than the tax code, also affect the operations and costs of manufacturing in the United States. In many cases, such laws are unique to the United States and, therefore, represent unique financial burdens on domestic manufacturers.

Discussion

Trade policies, as well as elements of domestic policies (antitrust, etc.) are significant determinants not only of the level of resources that are or can be devoted to defense, but of the productivity of the industries supporting our defense. From the perspective of security policy, the Department of Defense believes that in formulating trade policies, within the framework of international agreements, attention should be focused on the impact such policies have on American competitiveness and stimulating a productive manufacturing base. Domestic policies also should be examined from this perspective.

Recommendation

The Department of Defense advocates and supports the concept that there should be a comprehensive analysis of trade policy and domestic policies, specifically focused on enhancing the international competitiveness of American manufacturing industries. The Department of Defense recommends that the President cause such fundamental examinations to be undertaken as national priorities.

Education and Training

Conclusion

There is substantial evidence that the basic skill levels of many American high school graduates are not adequate for the needs of manufacturing firms. At the university level, curricula does not adequately focus on manufacturing processes, technologies, or management. Continuing education programs for professionals and workers alike are inadequate or nonexistent in most American firms.

Discussion

The Department of Defense is dependent upon a continuing flow of highly qualified mathematicians, scientists, engineers, and technicians, as well as an adequate supply of skilled, motivated line workers in manufacturing processes and maintenance programs. Shortages in these areas create market distortions, which disrupt development and production schedules, reduce quality, and increase costs. Education and training are the most fundamental long-term national priorities in the effort to sustain an advanced industrial economy and to provide adequately for our defense.

The Department of Defense traditionally has been and continues to be involved in scientific and technical educational programs, but has not recently subjected its educational programs to rigorous review from the perspective of modern industrial requirements. There also has been no recent fundamental examination of the quality or relevance of American educational systems (at all levels) specifically from the perspective of the needs of an advanced industrial economy. The combination of deficiencies in education and training at all levels represents, perhaps, the most serious long-term problem facing the United States industrial base.

Recommendation

The Department of Defense problem with respect to inadequate skill levels in the United States is a component part of the national problem. The Department recognizes that long-term basic solutions are beyond the scope of its responsibilities and capabilities and urges that there be a national effort, beginning now, to achieve these long-term solutions.

Private Sector Issues

Conclusion

Notwithstanding the continuing successes of some entire sectors of the United States manufacturing base and of individual firms in other sectors, there is a pervasive problem with the quality and effectiveness of management in American manufacturing industries.

Discussion

The findings of this study are, collectively, an indictment of management in American manufacturing firms. This is a particularly sensitive problem because Government has little or no ability to address the problem or to contribute to its solution. Of course, one exception is that Government should ensure that its current practices that are intrusions into the operations of manufacturing firms do in fact impose the least possible harm on these firms. However, this should not be construed to mean Government will shirk its oversight responsibilities. A less obvious exception lies in the potential for Government to influence the expectations and actions of owners and managers through, for example, changes to tax law to discourage an excessive focus on the short-term and to provide incentives for long-term investment in technology development and implementation.

Recommendation

The Department of Defense can contribute substantially to improved management in defense firms through improved acquisition processes, selective contract incentives based on competitive cost reductions, and a concommitant effort to reduce its intrusions into management's affairs. The management problem in non-defense industries, however, is largely beyond the reach of Government agencies. At a minimum, however, unnecessary Government barriers to management motivation to achieve manufacturing excellence and competitiveness must be identified and dismantled.

POST SCRIPT

by Dr. Robert B. Costello

Under Secretary of Defense (Acquisition)

The research that formed the basis for the recommendations contained in this report was conducted over more than a year's time. As good ideas came to the fore during this period, we chose to act upon them rather than await final publication of the report on this initiative. Some of the recommendations already are ongoing within the Department. For example, one key recommendation in this report, perhaps the highest priority, is directed to forging better relations with industry. Proper cooperation between industry and Government is essential for creating a *win–win* situation for both parties and for ensuring the existence of a healthy and vital industrial base from which the Department can draw its mission requirements.

To this end, the establishment of a Defense Manufacturing Board within the Department of Defense is underway. This new Board has an approved charter, and the nomination process for members has begun. The National Academy of Sciences has agreed informally to create a Defense Manufacturing Strategy Committee, referred to in the report as the Manufacturing Advisory Council. Nominees to this Committee also have been identified. The Defense Science Board has formed a Defense Industrial and Technology Base Task Force. This Task Force will examine in greater detail the recommendations we have made on bolstering defense industrial competitiveness. These beginning efforts should provide the foundation for a more effective partnership between the Department and the industries upon which we rely and for developing innovative solutions to both the short– and long–term problems identified in the report.

Two key actions required to ensure a comprehensive, sustained effort to implement these and other new initiatives are: (1) to provide a senior–level focal point to concentrate Departmental responsibilities for industrial base programs; and (2) to acquire the factual data required to support sound industrial base plans and programs.

Efforts are actively underway to establish the new position of Deputy Under Secretary of Defense (Production Base and International Technology), who was referred to in the report as the Department of Defense Production Base Advocate. Along with its institutional responsibilities to receive, evaluate, and test innovative ideas to improve Department of

Defense manufacturing programs, the Office of the Deputy Under Secretary of Defense (Production Base and International Technology) will serve as the focal point within the Office of the Secretary of Defense to oversee and coordinate all manufacturing-related activities of the Department.

The Office of the Deputy Under Secretary of Defense (Production Base and International Technology) also will be responsible for acquiring, organizing, maintaining, and disseminating data required for defense industrial base plans and programs. This effort already has begun with the staffing of a directive merging the Defense Industrial Network and Project SOCRATES into the Defense Industrial Base Information Administration. This effort will be broadened in the near future to develop means to identify critical foreign-sourced items in current and proposed weapon systems programs.

With these two key actions underway, the foundations are being laid for establishing the comprehensive, dedicated capabilities we require to manage effectively a great many discrete industrial base programs. Many of these already are underway and will continue, but they will be placed under the general cognizance of the Deputy Under Secretary of Defense (Production Base and International Technology) for oversight, policy guidance, and Department-level management.

Educational initiatives are, in the long-term, perhaps the most significant of the recommendations contained in the report. We intend to move resolutely, but cautiously, on these: resolutely because the issue of superior technical and scientific education is critical to the nation's future; cautiously because the Department of Defense properly is limited to a support role in this issue, which involves every level of Government.

A number of the remaining recommendations relate to efforts already in place within the Department or to recent new initiatives. This, of course, does not mean that we have solved all our problems. These are partial solutions to very complex problems that will continue to require our attention and the best ideas from industry, Government, and our allies.

For example, in order to help ensure that sectors critical to our security, such as the semiconductor and machine tool industries, become more internationally competitive in manufacturing technology, the Department has provided support for the establishment of a

Semiconductor Manufacturing Technology Consortium and a National Center For Manufacturing Science.

Our Total Quality Management effort is another example of a current effort underway within the Department that is in consonance with the findings of this study. We are working to broaden the focus of quality to change the present culture of the acquisition process, contractual requirements, design and manufacturing practices, and the modern concept of quality. We hope to provide the means to change the quality culture across the Department of Defense and industry by reducing weapon systems' costs while improving their quality in the field.

We are now in the process of forming a strategic planning task force, with membership from the Office of the Secretary of Defense, the Military Departments, the Organization of the Joint Chiefs of Staff, and the Defense Logistics Agency. The principal purpose of the task force will be to establish meaningful linkages between the materiel requirements of military operational plans and the industrial base and technology programs managed by the Deputy Under Secretary of Defense (Production Base and International Technology). A substantial portion of this task already has been accomplished and provides a solid foundation for the work of the task force. The Joint Industrial Mobilization Planning Process is the analytic and assessment process used by the Military Departments, Organization of the Joint Chiefs of Staff, and Defense Agencies to perform industrial capabilities analyses for the Joint Strategic Planning System and to link industrial mobilization plans to operational plans.

Substantial progress also has been made on the recommendations for: improving incentives for producibility enhancing investments; focusing the acquisition system on life cycle costs; increasing use of commercial product and process specifications; and greatly increasing our emphasis on the development of advanced manufacturing technology.

Contact also has been made with the Economic Policy Council in the Executive Office of the President in order to begin establishing a means of exploring further the national policy issues discussed in this report.

Many other efforts are being pursued within the Department of Defense. These, in conjunction with the new ideas emanating from this study, have formed the basis for implementing this action plan to bolster defense industrial competitiveness.

Mr. McCormack. In terms of the bearing industry specifically, our assessment of the influx of foreign bearings is documented in the Joint Logistics Commanders' Bearing Study, dated June 1986. It concluded that there has been a steady erosion of the commercial bearing sector since 1978, and that the industry is in, and I quote, "Imminent danger of being unable to support national defense needs."

In response to this, we have developed an action plan which is largely tied to the recommendations in the JLC report plus other efforts which we feel may prove constructive. I would like to summarize those briefly.

First, we are now restricting defense procurement of bearings to domestic sources, that is, the United States and Canada. I must comment here, in connection with that action that we have taken; that the role of Congresswoman Johnson and Congressman Spratt and the Congressional Bearing Caucus was most significant in our ability to arrive at a reasonable treatment of this delicate course of action. The cooperative approach, spearheaded by Congresswoman Johnson and Congressman Spratt in dealing with this type of issue, is a model which I would encourage others to consider.

On balance, I think we have done the best job possible in responding to interests of the Congress, the international community, and the near- and long-term interests of the Department of Defense. Our policy for the next 3 years will be to require all bearings and bearing components sold directly or indirectly to the Department of Defense to be of domestic manufacture.

We have excluded raw materials, such as steel and lubricants, from this restriction. We also have a waiver provision in the restriction, vested with the head of the contracting activity, which we believe is an appropriate level to ensure an understanding of the intent of our policy, and a reasonable degree of consistency in decisions and development of a workable solution.

If I could add parenthetically, Senator D'Amato, that the issue with respect to this is to ensure the integrity that this works and not just grant open waivers in the event of shortfall of production.

Also included are several needed exemptions dealing with subjects such as commercial products and overseas purchases. We will examine the continuing need for the restriction after 3 years, prior to exercising a 2-year extension.

Senator D'Amato. When will that come into play?

Mr. McCormack. That is effective now.

Senator D'Amato. Are you saying that at the present time all bearings purchased by the military are manufactured domestically?

Mr. McCormack. That is correct except where there is an existing contract that is in the process of being concluded, and our contracts typically run for 12 months. So there will be a rollover period of time. We did not go back and open up old contracts.

Senator D'Amato. When did that take effect? What was the effective date of that?

Mr. McCormack. August 4.

Senator D'Amato. It has just come into force?

Mr. McCormack. Yes, sir. It is at this point that I must reiterate the need for action by the bearing community. The continuation of this restriction will largely depend on a positive response by industry. We must see a measurable difference in industry commitment to improving product quality and lowering costs. We are now in the process of working with the Antifriction Bearing Manufacturers Association to assist in this next and vital step.

The second recommendation dealt with consolidating, coordinating, and increasing the funding for joint service/industry modernization programs. The two most notable programs are the Industrial Modernization Incentives Program and the Manufacturing Technology Program. These programs are complementary.

The IMIP Program provides a means for the Government and contractors to share in savings arising from a productivity improvement, and MANTECH funds provide for the development of generic manufacturing technology and move it from the lab to the factory floor.

In other words, we are going to support this industry financially in terms of developing those processes.

The third requirement of the study addressed the importance of our issuing projected requirements for bearings. We have a modeling system called the Defense Economic Impact Modeling System, which enables us to show defense procurement demand projected for direct and indirect purchase, for major categories of weapon and support systems, tied to our 5-year defense plan.

We are sharing this information currently with the industry to assist them in their long-term investment planning. The last recommendation called for examining the refurbishment capacity within the commercial industry and to determine an appropriate split between commercial and Department of Defense refurbishment.

The Bearing Working Group recently completed an additional study of this subject and issued a report in March 1988. Basically, the DOD will perform what is called level 1 and level 2 work which includes replacing roller elements and retainers and honing raceways. Levels 3 and 4 will be performed by the private sector.

Only bearings valued at over $150 per bearing are candidates for this activity. The actions are part of a more detailed plan developed by DOD to assist the industry. I would be pleased to offer our action plan for the record as it does offer further explanation of these and other initiatives that we are pursuing.

We are also exploring the possibility of a consortium among industry, academia, and Government to provide advanced product and manufacturing technologies. The Defense Logistics Agency is proposing to use an independent contractor to investigate this matter at this time. The JLC Bearing Study stated that "DOD actions alone will not resolve the problems facing the industry." The Bolstering Defense Industrial Competitiveness Report addresses this in the broader context, but clearly hinges on a cooperative effort.

I want to thank you for the opportunity to discuss this, and I am available to answer any questions.

[The prepared statement of Mr. McCormack follows:]

HOLD UNTIL RELEASED BY THE COMMITTEE

STATEMENT OF
MR. ROBERT C. MCCORMACK
DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR
PRODUCTION SUPPORT
TESTIMONY BEFORE THE SENATE SMALL BUSINESS COMMITTEE
ON THE
DOMESTIC BALL AND ROLLER BEARING INDUSTRY
9:30 A.M. 8 SEPTEMBER 1988

HOLD UNTIL RELEASED BY THE COMMITTEE

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. I APPRECIATE THIS OPPORTUNITY TO SHARE THE DEPARTMENT OF DEFENSE (DOD) PERSPECTIVE OF THE PROBLEMS FACING THE DOMESTIC BALL AND ROLLER BEARING INDUSTRY. AS YOU HAVE SUGGESTED, I WILL ADDRESS IT IN TERMS OF THE EFFECT FOREIGN COMPETITION HAS ON OUR NATIONAL SECURITY; WHERE WE ARE TODAY, AND WHAT CONGRESS CAN DO TO HELP REMEDY THESE PROBLEMS.

LET ME BEGIN BY SAYING THAT DOD CONSIDERS THE BEARING INDUSTRY TO BE AS CRITICAL TO OUR MILITARY READINESS AS MUNITIONS OR WEAPON SYSTEMS. BEARINGS ARE NOT ONLY USED IN THESE ITEMS BUT ARE ESSENTIAL IN THEIR PRODUCTION. I WANT TO DISPEL ANY DOUBT ABOUT THE IMPORTANCE OF BEARINGS TO THE NATIONAL SECURITY. THE ISSUE IS THE VITALITY OF A DOMESTIC INDUSTRIAL BASE FOR BEARINGS - IS IT IMPORTANT? IS IT THREATENED? AND IF SO, WHAT ARE WE GOING TO DO ABOUT IT? YES, WE BELIEVE THAT IT IS ABSOLUTELY ESSENTIAL TO HAVE A VIABLE AND RESPONSIVE DOMESTIC BEARING INDUSTRY TO SUPPORT CRISIS REQUIREMENTS. YES, WE BELIEVE THIS INDUSTRY IS FACED WITH A SERIOUS DECLINE TO THE EXTENT THAT WE WILL NOT BE ABLE TO MEET THOSE REQUIREMENTS, DUE IN PART TO FOREIGN COMPETITION. THE NEXT QUESTION, HOWEVER, "WHAT ARE

WE GOING TO DO ABOUT IT?" IS WHERE THE DEBATE BEGINS. LET ME DISCUSS THE PROBLEMS CONFRONTING US IN A BROADER CONTEXT AND THEN ADDRESS THE BEARING SITUATION.

AS YOU ARE PROBABLY AWARE, WE HAVE JUST RELEASED A COMPREHENSIVE REPORT ENTITLED "BOLSTERING DEFENSE INDUSTRIAL COMPETITIVENESS." THIS INITIATIVE WAS UNDERTAKEN IN SUPPORT OF THE PRESIDENT'S COMPETITIVENESS INITIATIVE AND REPRESENTS THE DOD'S BEST EFFORT TO DO ITS PART TO HELP ENSURE THE FUTURE HEALTH AND VITALITY OF OUR INDUSTRIAL BASE. THE REPORT CONCLUDES THAT MEETING U.S. SECURITY NEEDS WILL REQUIRE A HEALTHY MANUFACTURING BASE FROM WHICH THE DOD CAN DRAW ITS REQUIREMENTS, BOTH IN PEACETIME AND IN EMERGENCIES. IT REPRESENTS A YEAR'S EFFORT AND INVOLVED SOME OF THE VERY BEST EXPERT ADVICE AVAILABLE IN THE NATION. THE FOCUS OF THE EFFORT WAS THE MANUFACTURING INDUSTRIES THAT SUPPORT DEFENSE REQUIREMENTS. IT WAS NOT OUR INTENTION TO MAKE THE CASE THAT ALL U.S. MANUFACTURING IS IN TROUBLE, SINCE CLEARLY, THIS IS NOT THE CASE. SOME SECTORS ARE HEALTHY AND FIERCELY COMPETITIVE IN TODAY'S MARKETPLACE. OUR CONCERN IS WITH THOSE INDUSTRIES WHICH ARE LOSING THEIR ABILITY TO COMPETE IN THE INTERNATIONAL

MARKETPLACE AND ARE PARTICULARLY CRITICAL TO U.S. SECURITY NEEDS, EITHER BECAUSE THEY REPRESENT KEY PRODUCTION TECHNOLOGIES AND EQUIPMENT, OR THEIR VERY EXISTENCE IS VITAL TO THE TECHNOLOGICAL AND MANUFACTURING LEADERSHIP OF THE UNITED STATES. THE BEARING INDUSTRY IS ONE SUCH SECTOR.

I WILL NOT ELABORATE ON THE REPORT DETAILS, BUT A KEY PART IS RECOGNIZING THAT THE ISSUES AND RECOMMENDATIONS WERE NOT LIMITED TO DOD POLICIES AND PRACTICES. THEY INVOLVED THOSE RELATED TO A NATIONAL AGENDA REQUIRING ACTIONS BEYOND THE SCOPE AND AUTHORITY OF THE DOD. THIS DOES NOT MEAN THAT DOD SHOULD BE ABSOLVED. OUR REPORT CALLS FOR DEFENSE ACTION, AND IMPLEMENTATION IS A TOP PRIORITY OF THE UNDER SECRETARY OF DEFENSE FOR ACQUISITION. THE COMPETITIVENESS ISSUE WILL REQUIRE NOT ONLY THE DOD BUT, ELEMENTS, BOTH IN AND OUT OF GOVERNMENT INCLUDING THE CONGRESS TO DEAL SUCCESSFULLY WITH THE PROBLEMS IDENTIFIED.

IN TERMS OF THE BEARING INDUSTRY SPECIFICALLY, OUR ASSESSMENT OF THE INFLUX OF FOREIGN BEARINGS IS DOCUMENTED IN THE JOINT LOGISTICS COMMANDERS' (JLC) BEARING STUDY COMPLETED IN JUNE

1986. IT CONCLUDED THAT THERE HAS BEEN A STEADY EROSION OF THE COMMERCIAL BEARING SECTOR SINCE 1978 AND THAT THE INDUSTRY IS IN "IMMINENT DANGER OF BEING UNABLE TO SUPPORT NATIONAL DEFENSE NEEDS." WE BELIEVE THIS TO BE TRUE STILL.

IN RESPONSE TO THIS PROBLEM, WE HAVE DEVELOPED AN ACTION PLAN WHICH ADDRESSES THE RECOMMENDATIONS IN THE JLC REPORT, PLUS ADDITIONAL EFFORTS THAT MAY PROVE CONSTRUCTIVE. I WOULD LIKE TO DISCUSS BRIEFLY A FEW OF THE ACTIONS WE ARE PURSUING.

FIRST, IS THE EFFORT TO RESTRICT DEFENSE PROCUREMENT OF BEARINGS TO DOMESTIC SOURCES, THAT IS, THE U.S. AND CANADA. THIS RESTRICTION WAS PUBLISHED AS AN INTERIM RULE IN THE AUGUST 4 PUBLICATION OF THE FEDERAL REGISTER. THE RULE IS NOW A MATTER OF DOD PROCUREMENT POLICY AND WILL BECOME A FINAL RULE AFTER AN APPROPRIATE PUBLIC COMMENT PERIOD.

AS FAR AS ACTIONS THAT CAN BE TAKEN BY THE CONGRESS, THE ROLE OF CONGRESSWOMAN JOHNSON, CONGRESSMAN SPRATT, AND THE CONGRESSIONAL BEARING CAUCUS WAS MOST SIGNIFICANT IN OUR ABILITY TO ARRIVE AT A REASONABLE TREATMENT OF THIS DELICATE

COURSE OF ACTION. THE COOPERATIVE APPROACH, SPEARHEADED BY CONGRESSWOMAN JOHNSON AND CONGRESSMAN SPRATT IN DEALING WITH THIS ISSUE, IS A MODEL WHICH I WOULD ENCOURAGE OTHERS TO CONSIDER.

ON BALANCE, I THINK WE HAVE DONE THE BEST JOB POSSIBLE IN RESPONDING TO INTERESTS OF THE CONGRESS, THE INTERNATIONAL COMMUNITY, AND THE NEAR AND LONG TERM INTERESTS OF THE DOD. OUR POLICY FOR THE NEXT THREE YEARS WILL BE TO REQUIRE ALL BEARINGS AND BEARING COMPONENTS SOLD DIRECTLY OR INDIRECTLY TO THE DOD TO BE OF DOMESTIC MANUFACTURE. WE HAVE EXCLUDED RAW MATERIALS, SUCH AS STEEL AND LUBRICANTS, FROM THE RESTRICTION. WE ALSO HAVE A WAIVER PROVISION IN THE RESTRICTION, VESTED WITH THE HEAD OF THE CONTRACTING ACTIVITY, WHICH WE BELIEVE IS AN APPROPRIATE LEVEL TO ENSURE AN UNDERSTANDING OF THE INTENT OF OUR POLICY, AND A REASONABLE DEGREE OF CONSISTENCY IN DECISIONS AND DEVELOPMENT OF WORKABLE SOLUTIONS. ALSO INCLUDED ARE SEVERAL NEEDED EXEMPTIONS DEALING WITH SUBJECTS, SUCH AS COMMERCIAL PRODUCTS AND OVERSEAS PURCHASES. WE WILL EXAMINE THE

CONTINUED NEED FOR THE RESTRICTION AFTER 3 YEARS PRIOR TO EXERCISING A 2 YEAR EXTENSION.

I MUST REITERATE THE NEED FOR ACTION BY THE BEARING COMMUNITY. THE CONTINUATION OF THIS RESTRICTION WILL LARGELY DEPEND ON A POSITIVE RESPONSE BY INDUSTRY. WE MUST SEE A MEASURABLE DIFFERENCE IN INDUSTRY COMMITMENT TO IMPROVE PRODUCT QUALITY AND TO LOWER COSTS. WE ARE WORKING WITH THE ANTIFRICTION BEARING MANUFACTURERS' ASSOCIATION TO ASSIST IN THIS NEXT AND VITAL STEP.

THE SECOND RECOMMENDATION OF THE JLC BEARING STUDY DEALT WITH CONSOLIDATING, COORDINATING, AND INCREASING THE FUNDING FOR JOINT SERVICE/INDUSTRY MODERNIZATION PROGRAMS. THE TWO MOST NOTABLE PROGRAMS ARE THE INDUSTRIAL MODERNIZATION INCENTIVES PROGRAM (IMIP) AND THE MANUFACTURING TECHNOLOGY (MANTECH) PROGRAM. THESE PROGRAMS ARE COMPLEMENTARY. IMIP PROVIDES A MEANS FOR GOVERNMENT AND A CONTRACTOR TO SHARE IN SAVINGS ARISING FROM A PRODUCTIVITY IMPROVEMENT INVESTMENT, WHILE MANTECH FUNDS DEVELOPMENT OF GENERIC MANUFACTURING TECHNOLOGY AND MOVES IT FROM THE LAB TO THE FACTORY FLOOR.

THESE ARE EXAMPLES OF DOD PROGRAMS WHICH CAN POTENTIALLY HELP WITH BOLSTERING THE DEFENSE INDUSTRIAL BASE.

THE THIRD RECOMMENDATION OF THE JLC STUDY ADDRESSED THE IMPORTANT ISSUE OF PROJECTING REQUIREMENTS. WE DO NOT HAVE AN INCLUSIVE REQUIREMENTS ESTIMATING PROCESS. WE ARE USING A MODELING SYSTEM CALLED THE DEFENSE ECONOMIC IMPACT MODELING SYSTEM, WHICH ENABLES US TO SHOW DEFENSE PROCUREMENT DEMAND PROJECTIONS FOR DIRECT AND INDIRECT PURCHASES FOR MAJOR CATEGORIES OF WEAPON AND SUPPORT SYSTEMS TIED TO THE FIVE YEAR DEFENSE PLAN. WE ARE SHARING THIS INFORMATION WITH THE INDUSTRY TO ASSIST IN ITS LONG TERM INVESTMENT PLANNING. REGRETTABLY, WE HAVE NOT RECEIVED INDUSTRY FEEDBACK REGARDING THE UTILITY THIS DATA MAY HAVE FOR THE INDUSTRY'S BUSINESS STRATEGIES.

THE LAST RECOMMENDATION OF THE JLC STUDY CALLED FOR EXAMINING THE REFURBISHMENT CAPACITY WITHIN THE COMMERCIAL INDUSTRY AND TO DETERMINE AN APPROPRIATE SPLIT BETWEEN COMMERCIAL AND DOD REFURBISHMENT. THE BEARING WORKING GROUP RECENTLY COMPLETED AN ADDITIONAL STUDY OF THIS SUBJECT AND ISSUED A

REPORT IN MARCH 1988. IN THAT REPORT, AN EXTENSIVE ANALYSIS WAS MADE OF THE TOTAL DOD BEARING REFURBISHMENT REQUIREMENT AND AN ANALYSIS OF HOW IT SHOULD BE DIVIDED BETWEEN THE DOD AND PRIVATE SECTOR. BASICALLY, THE DOD WILL PERFORM WHAT IS CALLED LEVEL I AND REWORK, WHICH INCLUDES REPLACING ROLLING ELEMENTS AND RETAINERS AND HONING RACEWAYS. LEVELS III AND REWORK WILL BE PERFORMED BY THE PRIVATE SECTOR, WHICH WOULD INCLUDE MORE EXTENSIVE REWORK OF INNER AND OUTER RINGS AND MANUFACTURING NEW COMPONENTS. ONLY BEARINGS VALUED AT OVER $150 PER BEARING ARE CANDIDATES. THE REPORT INDICATES THE SERVICES ARE REWORKING ABOUT 3600 BEARINGS PER YEAR. HOWEVER, WITH INCREASED EMPHASIS AND COMMITMENTS TO THIS ENDEAVOR, THE STUDY ESTIMATES THAT PERHAPS AS MANY AS 28,500 BEARINGS COULD BE RETURNED TO SERVICE ANNUALLY AS A RESULT OF REFURBISHMENT. IN MARCH OF THIS YEAR, THE JOINT LOGISTICS COMMANDERS SIGNED AN AGREEMENT CONCURRING WITH THE FINDINGS AND RECOMMENDATIONS AND AGREEING TO TAKE THE NECESSARY INDIVIDUAL ACTIONS WITHIN RESPECTIVE SERVICES TO CARRY OUT THE RECOMMENDATIONS.

THESE ACTIONS ARE A PART OF A MORE DETAILED ACTION PLAN DEVELOPED BY THE DOD TO ASSIST THIS INDUSTRY. OUR ACTION PLAN PROVIDES FURTHER EXPLANATION OF THESE AND OTHER INITIATIVES WE ARE EITHER CONSIDERING OR PURSUING. WE ARE ALSO EXPLORING THE POSSIBILITIES OF A CONSORTIUM AMONG INDUSTRY, ACADEMIA, AND GOVERNMENT TO PROVIDE ADVANCED PRODUCT AND MANUFACTURING TECHNOLOGIES. SIMILAR CONSORTIA HAVE ALREADY BEEN UNDERTAKEN IN THE SEMICONDUCTOR INDUSTRY REPRESENTED BY THE SEMATECH CORPORATION AND IN THE MACHINE TOOL INDUSTRY WITH THE NATIONAL CENTER FOR MANUFACTURING SCIENCES.

WITH REGARD TO RECOMMENDED CONGRESSIONAL ACTIONS, I WOULD AGAIN POINT TO THE ACTIONS OF THE BEARING CAUCUS, WHICH DEMONSTRATED THAT THROUGH COORDINATED COMMUNICATION, BOTH ADMINISTRATION AND CONGRESSIONAL INTERESTS CAN BE PURSUED. WE BELIEVE THAT OUR REPORT ON BOLSTERING DEFENSE INDUSTRIAL COMPETITIVENESS ADEQUATELY DESCRIBES AN AGENDA FOR THE FUTURE. THE JLC BEARING STUDY STATED THAT "DOD ACTIONS ALONE WILL NOT RESOLVE THE PROBLEMS FACING THE INDUSTRY." THE "BOLSTERING DEFENSE INDUSTRIAL COMPETITIVENESS" REPORT ADDRESSES INDUSTRY PROBLEMS IN THE BROADER CONTEXT. SUCCESS

HINGES ON A COOPERATIVE EFFORT AMONG THE CONGRESS, DOD, AND INDUSTRY.

CONGRESS CAN GREATLY ASSIST BY SUPPORTING OUR INITIATIVES AND BY CONVEYING INFORMATION ABOUT OUR EFFORTS TO THE PUBLIC. I HOPE THAT DOD HAS DEMONSTRATED ITS CONCERN FOR THIS IMPORTANT ISSUE THROUGH FOLLOW-ON ACTIONS RESULTING FROM STUDIES AND REPORTS.

I THANK YOU FOR THIS OPPORTUNITY TO TESTIFY ON THIS IMPORTANT SUBJECT AND I WOULD BE DELIGHTED TO RESPOND TO ANY FURTHER QUESTIONS YOU MAY HAVE AT THIS TIME.

377-2597 [illegible]
377-5270 Fox
377-4260 Goldman

U. S. DEPARTMENT OF DEFENSE

BEARING ACTION PLAN

In Response to House Appropriations
Committee (HAC) Report 99-793

Amendment to the DoD
Bearing Action Plan*

I. Section A4, page 4, of the DoD Bearing Action Plan is hereby rescinded. This section is not in compliance with the DoD policy on competition in contracting. It would give foreign producers of countries with whom we have bilateral and multilateral agreements an unfair competitive advantage over US producers. Such producers would have access to foreign-made bearings, which are available at lower prices than domestic bearings. DoD competition in contracting policy states that foreign producers shall compete under the same rules as US producers.

II. Section A5, page 4, of the DoD Bearing Action Plan is hereby expanded to read:

> "Provide an exception to the procurement restriction for US allies in Government-to-Government co-development and co-production projects, for allied portions of the projects."

Approved:

Deputy Secretary of Defense

29 JUL 1987
Date

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* This amendment is necessary in view of DoD competitive acquisition regulations. The amendment will be explained in detail in the "Bearing Procurement Restriction Implementation Guidelines" to be distributed with the official announcement of the restriction's effective date.

I. INTRODUCTION

The purpose of this Action Plan is to respond to a requirement contained in the Report of the House Committee on Appropriations, Department of Defense Appropriations Bill, 1987 (Report 99-793). The Report requires the Secretary of Defense to submit a plan for implementing recommendations made in the Joint Logistics Commanders (JLC) "Bearing Study" of July 1986. Specifically, the Report states:

> "Domestic Ball Bearing Industry
>
> In its report on fiscal year 1986 appropriations, the Committee directed the Department to study and report on the state of the domestic ball bearing industry. A report entitled, "Joint Logistics Commanders Bearing Study" was issued on June 18, 1986. It concludes that the domestic ball bearing industry is in jeopardy, and recommends a number of steps to reverse current adverse trends. The Committee requests that the Secretary of Defense review these findings and recommendations, and submit his conclusions and plan for implementation to the Committee on Appropriations and Armed Services not later than December 31, 1986."

The Action Plan addresses the JLC recommendations for unilateral DoD action to assist the U.S. bearing industry. It does not specifically address those policy options recommended for interagency consideration.

The actions recommended for the DoD were:

1. "Initiate a time-limited Federal Acquisition Regulation (FAR) restriction for the procurement of domestic bearings for all DoD uses, providing exceptions and waivers which are in the Government's best interests. This will initially ensure domestically manufactured bearings for DoD applications."

2. "Consolidate, coordinate, and increase funding for joint Service/industry modernization programs for domestic bearing manufacturers."

3. "Investigate DoD capabilities and industry needs for a projection of bearings requirements."

4. "Examine refurbishment capacity within the commercial industry and determine the appropriate split between commercial and DoD refurbishment workloads."

In addition to the above four actions, the action plan provides for independently conceived measures to enhance the strategic capabilities of the bearing industry. The DoD will organize two conferences, a Cost-Driver Conference and a Procurement Conference; the first will identify problem areas in the industry, the second will provide information on DoD procurement plans. The Department will also make available pertinent technical data generated by the Defense Technology Information Council (DTIC).

The premise for the Bearing Action Plan is the advancement of critical industrial preparedness to meet national emergencies. The DoD must balance its commitment to competition in procurement with its commitment to providing an adequate mobilization base comprised of both domestic and foreign-sourced items. Not all items can be produced domestically, but for some components National Capabilities are absolutely essential. Bearings are fundamental to every defense weapon system. The U.S. requires a healthy domestic bearing industry with production capacity for precision and superprecision bearings, as well as for large quantities of commercial type bearings. Such overall capability demands an industry which is competitive in international and home markets.

We have carefully studied the current position of the U.S. bearing industry. U.S. firms are uncompetitive in many respects with foreign conglomerates targeting international markets for increased market shares. Capacity utilization rates are in the danger zone. We are convinced that if utilization decreases further, large amounts of critical capacity will be retired. The ability to produce bearings from start to finish domestically including bearing components, is in serious jeopardy. Foreign companies on U.S. soil are importing components or planning to import components from distant markets which pose a strategic risk to the industrial base should foreign dependency develop.

For these reasons, the DoD will undertake the following plan of action. The objective of all the actions in the plan is to ensure preservation of essential defense industrial capacity while allowing the industry time to improve its competitive position.

II. DoD Detailed Plan of Action:

A. FAR Restriction:

1. Require that all bearings (including components and materials available in the U.S.) purchased directly or indirectly by the DoD for use in military end-items or subassemblies (and not contained in contracts concluded before the restriction

goes into effect) shall be manufactured within the domestic production base (including Canada) for three calendar years, effective from the date of enactment.

2. Provide an exception to the restriction for steel rod and ball wire used to produce bearing balls and for other bearing components not currently produced in the United States.

3. Provide for periodic DoD review of the industry's competitive situation during the period of procurement restraint. Reviews shall seek evidence of an industry plan and active endeavors to retain long-term essential strategic capacity for military bearings. Reviews shall also verify industry plans and actions to regain an international competitive position through enhanced investments in state-of-the-art technologies and management improvements.

4. Provide an exception to the restriction for end-items purchased overseas under bilateral or multilateral agreements.

5. Provide an exception to the restriction for co-production and co-development projects with ~~NATO~~ the allies, ~~in existence as of February 15, 1987.~~

6. The procurement restriction will be lifted at the end of three years if no evidence of productivity or quality enhancing improvements by the industry is shown during periodic OSD reviews.

7. The three-year restriction may be extended for another two years if sufficient cause demonstrated for maintaining them in conjunction with other U.S. Government policies intended to improve the industry's long-term competitiveness.

B. Defense Research and Development Programs:

1. Cost-Driver Conference:

A DoD Component will be identified to plan and execute a Cost Driver Conference for the bearing industry under the policy guidance of the Office of the Secretary of Defense. The lead COMPONENT will solicit papers from the bearing industry, the Department of Commerce, and other DoD Components on efficiency in key aspects of the industry's operations. The conference will consist of panels discussing any papers submitted, and ranking each in terms of greatest potential modernization benefit.

Following the conference, the lead component will be responsible for aggregating the bearing industry's technological needs and will submit a budget request to provide funds for projects under the Manufacturing Technology (MANTECH) or the Industrial Modernization Incentives Program (IMIP). Any funding decisions will be based on the needs of the DoD Components for the types of material most affected by shortages in U.S. bearing production capabilities.

2. Title III of the Defense Production Act:

Title III of the Defense Production Act includes provisions enabling the Secretaries of Commerce and Defense to certify an inadequacy of industrial capacity to meet defense needs in any industry sector. If an inadequacy is certified, funds may be provided to expand or create capacity to meet the need.

The DoD and the DoC will evaluate the amounts and types of bearing capacity required for industrial responsiveness. This will be done in fulfillment of this plan. Actual capacity will be monitored annually to determine its adequacy. To the extent that capacity falls below defense requirements, or production capacity for new types of bearings is lacking, the Departments will be willing to consider financial assistance under Title III.

3. Research in DoD Materials Laboratory Technology Base Programs:

The Tribomaterials Working Group (TWG), a subgroup of the Joint Directors of Laboratories, Technical Panel on Advanced Materials, will work with the Joint Logistics Commanders Bearing Working Group to develop a research project involving the U.S. bearing industry.

4. MANTECH and IMIP:

Several potential projects for improving processing technology for the production of bearings have been explored by the Air Force. These projects include processes such as: a) single point turning, b) advanced grinding techniques, c) automation aids for machine set-up, d) tool control, and e) inspection and monitoring. The DoD will actively consider funding one or more of these programs. The basic funding criteria for any specific R&D project will be:

o The technology developed must be of use to the industry as a whole; and

o When implemented by DoD or its contractors, the technology developed must provide a direct material benefit to the acquisition of DoD materials.

C. DoD Information Systems:

1. Procurement Conference:

The DoD, in cooperation with the Department of Commerce, the National Anti-Friction Bearing Manufacturers Association, and individual bearing users and producers will hold a bearing procurement conference. The conference will consist of a series of briefings by the Military Departments and DoD Components identifying potential DoD and contractor requirements for precision and superprecision bearings.

2. Defense Economic Impact Modeling System:

The DoD will utilize the Defense Economic Impact Modeling System (DEIMS) to generate five-year projections of DoD bearing purchases. These projections indicate DoD outlays on bearings by major budget category. If possible, the Office of Industrial Base Assessment will also provide this information by region.

DEIMS information will be provided to the National Anti-Friction Bearing Manufacturers Association and any company requesting it. However, distribution will be limited to U.S. citizens.

3. National Center for Manufacturing Sciences:

Background: To meet the crisis that is developing because of the loss of our nation's long-held international competitive edge in manufacturing, a group of major U.S. manufacturers and machine tool builders have agreed that a unique new national organization is required. The National Center for Manufacturing Sciences will expand the nation's manufacturing knowledge base and expedite its dissemination and use by the sponsorship and coordination of various research, development, and technology transfer initiatives.

The objectives of the Center will be:

a. to assess the future directions of manufacturing worldwide;

b. to define the future scientific and technological requirements of U.S. manufacturing;

c. to evaluate U.S. technologies to determine adequacy of existing technologies;

d. to define the additional skills and knowledge needed to compete in international markets;

e. to develop ongoing relationships with universities, research institutes, and other organizations; and

f. to sponsor technical and research programs with the above organizations.

Action: The DoD will maintain close contact with the National Center for Manufacturing Sciences, convey information on its activities to firms who are not members, provide information on critical strategic needs to Center employees, and facilitate interaction between the Center and DoD Components. In this way, the DoD will assure that U.S. industries posing risks to the mobilization base receive prime attention from both DoD and major U.S. research institutions.

D. DoD Requirements Determination:

Take action to implement the JLC Bearing Working Group's recommendations on requirements determination. Also take action to initiate a DoD-wide assessment of required levels of industrial production acceleration capability for specific defense items, based on an appropriate multiple of peacetime buys for weapon system components and spares over the most recent five-year period. Such an assessment will be instituted by all Services, the Defense Logistics Agency, and the Office of the Secretary of Defense for the purpose of DoD industrial base policy actions.

E. Reallocation of DoD Refurbishment Market:

Take action to implement the JLC Bearing Working Group's recommendations on reallocating part of the DoD refurbishment market to private industry. Do not allocate that portion of the market essential to mobilization preparedness.

F. Continue to study with the Department of Commerce, the policies affecting the bearing industry in the commercial sector of the economy and the policies of other countries toward bearing manufacturers.

Questions from Senator Weicker and answers by Mr. McCormack

Senator Weicker. Mr. McCormack, how many bearings does Defense use in its military programs? What are some of the critical uses of these bearings?

Mr. McCormack. The estimates for the DoD consumption of bearings is slightly less than 20% of the total domestic market of $3.5 billion in 1987. The Joint Logistics Commanders' Bearing Refurbishment Study, published in March 1988, indicated that the DoD has a demand for new bearings, that is in the replacement area, of about 257,000 bearings annually. The application of bearings is far ranging computers, missiles, aircraft, tanks, ships, and satellites to name a few. Without bearings, our fighting forces would be driven to hand-to-hand combat.

Senator Weicker. What percent of the bearings used by Defense are from foreign sources?

Mr. McCormack. We currently do not have a comprehensive data base to provide precise information on the overall foreign involvement in DoD bearing procurements. We believe the Department's dependence on foreign bearings mirrors that of the overall economy, which is approximately 35%. We are currently developing an automated data base system called the Defense Industrial Network or DINET that will eventually enable us to have more complete insight into our dependence on foreign products.

Senator Weicker. Who are your principal suppliers of bearings?

Mr. McCormack. Our records indicate that DoD suppliers are widely divided across the array of recognized bearing manufacturers. Names such as Timken, Torrington-Fafnir, MPB, Barden, SKF, FAG, Rexnard, and TRW are just some of them.

Senator Weicker. We have all seen the recent report on the supply of faulty fasteners to the Defense Department. Have there been any related problems in the supply of bearings to Defense?

Mr. McCormack. There are two cases that are currently being investigated by the Defense Criminal Investigative Service of the DoDIG that involve possible fraudulent activity by bearing suppliers. We are not aware that any faulty products have been found as of this date.

Senator Weicker. Do you have any testing programs to assure the quality of bearings supplied to DoD? Are there any efforts being made at this time? How many?

Mr. McCormack. The DoD does have a number of testing laboratories around the country that are on contract to support our needs. Due to the large volume of items that we procure, it is not practical or desireable to test all those products. When we have evidence that products are not complying to our specifications, as in the case of fasteners, we do engage in a more comprehensive incoming inspection and test program. If there is evidence that bearings are a target of fraudulent procurement activity, we will begin a more comprehensive incoming inspection program in that area.

Senator Weicker. Mr. McCormack, you have overseen the development of the new Federal Acquisition Regulation (FAR). Does this action have any impact upon the domestic industry's sales of commercial or commodity type bearings?

Mr. McCormack. We believe the DoD bearing procurement restrictions will have some positive impact in the sales of commercial or commodity type bearings; however, to a lesser degree than for precision bearings. The restriction does have an exemption that states that commercial products containing bearings may continue to use the foreign bearing. This exemption is consistent with our policy to purchase off-the-shelf or commercial products whenever they meet our requirements. It also recognizes the economic reality that the DoD represents a small portion of most commercial product sales.

Senator Weicker. Mr. McCormack, the 1986 DoD study of the bearing industry clearly pointed out that if the Federal government does not reduce or eliminate the growing import share of the domestic bearing market that our defense capability will be jeopardized. Has Defense seen any efforts that other Federal agencies have initiated on their own to protect our national security?

Mr. McCormack. The DoD is aware of related bearing investigations underway at the Department of Commerce involving a Section 232 petition and an antidumping case on ball bearings. We are not aware of any other government activity.

Senator Weicker. Defense's new FAR has included a significant exemption to a foreign bearing maker. (a) Would you please tell the Committee why such an exemption was made? (b) What impacts will this exemption have upon the FAR assisting domestic manufacturers? (c) Won't other foreign bearing makers ask DoD to give them the same treatment as the FAG Corporation? (d) Will you please prepare and submit to the Committee a justification for the exemption and an analysis of the impact of this exemption on the new FAR's attempts to help domestic bearing suppliers:

Mr. McCormack. (a) The DoD bearing restriction has a provision for an exemption for bearing manufacturers with headquarters in NATO nations and U.S. manufacturing subsidiaries that export bearings. This exemption is intended to provide a limited business opportunity for companies with their headquarters located in a NATO nation. (b) Based on the preliminary information currently available on the one qualifying company to date, the impact on domestic manufacturers of this particular exemption will be minimal. We estimate about 1 to 2 percent of the total DoD business. (c) One other company located in the Federal Republic of Germany has approached the DoD and may be qualified. Our initial review indicates their level of involvement would be very small. (d) Yes, we will submit the requested justification.

Questions from Senator D'Amato and answers by Mr. McCormack

Senator D'Amato. The Joint Logistics Commanders' Ball Bearing Study made certain recommendations. By issuing on August 4 an interim rule restricting most defense procurements of bearings, components of bearings, or items containing bearings, to those manufactured in the U.S., Defense has taken action on one of those recommendations. In your prepared statement, you comment on the second recommendation regarding the Industrial Modernization Incentives Program (IMIP) and the Manufacturing Technology Program (MANTECH). Both of these programs require funding to be effective. How much money will Defense commit to these programs to help the U.S. Bearing Industry? In FY89?

Mr. McCormack. The Services and the Defense Logistics Agency currently have almost a $200 million budget in FY89 for the Manufacturing Technology and Industrial Modernization Incentives Programs. We can, if needed, reprogram any portion of those funds toward specific bearing manufacturing projects. The extent of either programs involvement will depend in part on the industry itself identifying its needs. We believe we have an excellent channel of communication established with the industry through the Anti-Friction Bearing Manufacturers Association.

Senator D'Amato. As you correctly point out in your statement, defense procurement needs in peacetime are not enough by themselves to support a large enough domestic bearing industry to meet our surge or mobilization needs in wartime. If foreign predatory and illegal business activities continue to be directed at the U.S. Bearing Industry, can initiatives like IMIP and MANTECH really work?

Mr. McCormack. Industry and government must continue to work together and to be vigilant against foreign governments and/or industries that are engaged in illegal activities aimed at dominating a particular industrial segment. Obviously, if such a foreign effort were to result in the complete loss of domestic capacity, our MANTECH and IMIP programs would be of no value.

Senator D'Amato. On the broader issue of preservation of the U.S. Defense Industrial Base, has the Defense Department formally coordinated with customs to identify those industries and industry segments that are threatened by foreign competition?

Mr. McCormack. The DoD is actively engaged with many federal agencies, including the Customs Service, to identify industrial sectors threatened by foreign competitors. The DoD is developing a data base called the Defense Industrial Network (DINET), which will enable us to take a more proactive role in dealing with this issue.

Senator D'Amato. Would you view it as useful in terms of our trade and international security negotiations to identify instances where Japan's Ministry of International Trade and Industry (MITI) might be coordinating commercial efforts to dominate aspects of U.S. industry that are critical to our national security?

Mr. McCormack. Yes, we believe it would be beneficial to have insight into foreign governments' intervention into the U.S. commercial market place.

Senator D'Amato. Do you believe that such coordinated commercial assaults on critical U.S. industries have implications that reach beyond fair trade and need to be addressed in a more serious, systematic manner at higher levels?

Mr. McCormack. The DoD has no evidence that foreign governments are plotting to dominate domestic industries vital to national security. If such evidence existed, there are adequate mechanisms available to the government to deal with the matter.

Senator D'Amato. Do you believe there is enough cooperation between U.S. agencies to deal with situations where what would ordinarily be simple trade issues become national security issues?

Mr. McCormack. Yes, I believe there is a reasonably good cooperation between governmental agencies.

Senator D'AMATO. Thank you very much. Mr. Bergan.

STATEMENT OF TIMOTHY N. BERGAN, DEPUTY ASSISTANT SECRETARY OF COMMERCE FOR IMPORT ADMINISTRATION

Mr. BERGAN. Thank you, Senator D'Amato. I appreciate the opportunity to testify before the Committee. I will attempt to summarize my remarks that have been included in the testimony submitted to the Committee, and to be brief as you and the Chairman have requested.

I would like to take this opportunity to say that this is my first time testifying at the U.S. Senate, and it is appropriate to do so before this Committee because when I worked here, I had the privilege of working with the Committee and Senators and staff for a number of years. So I am pleased to be here for that reason as well.

In short summary of my prepared testimony I would like to touch on our analysis of the importance and condition of the bearing industry which in concept and in substance parallels that testimony which has been provided earlier today.

The bearing industry is an essential element of the U.S. manufacturing base particularly because antifriction bearings have widespread applications in virtually all industrial products with moving metal parts.

At the present time, the domestic industry is operating near full peacetime capacity, which we consider to be a positive development. However, it is important to note that during the last decade, the domestic bearing industry encountered economic difficulties which led to a significant contraction of production capacity.

Senator D'AMATO. What were those? Give me your last statement.

Mr. BERGAN. It is important to note that during the last decade, the domestic bearing industry encountered economic difficulties which led to a significant contraction of production capacity.

Senator D'AMATO. What were those?

Mr. BERGAN. The difficulties?

Senator D'AMATO. Yes.

Mr. BERGAN. The difficulties, we believe, included major challenges from foreign competition, particularly from larger European and Japanese bearing corporations. The state of the industry is also characterized by a reduction in the amount of domestic shipments since 1979, a decline in employment, and a decline in profitability.

These trends have also led to increased foreign penetration of the U.S. market in some product lines. Taking these factors into account, the Administration has devoted considerable attention to analysis of the bearing industry's problems. In response, the Administration, through the Department of Defense, has developed a Bearing Action Plan which is intended to improve the antifriction bearing industry's ability to meet national security requirements.

As Mr. McCormack has indicated and you are aware, that includes Federal acquisition regulations and steps designed to facilitate the modernization of the industry and to integrate the domestic bearing manufacturers more fully into the defense procurement process.

I would now like to touch just briefly on Department of Commerce activities with respect to the section 232 investigation, and then on the antidumping and countervailing duty investigations underway. Secretary Verity forwarded the Department's section 232 report on antifriction bearings to the President on July 15, 1988.

The report included an analysis of domestic production needed to support defense and essential civilian demand for bearings and the capacity of the domestic bearing industry—as well as reliable imports—to meet that demand. We also reviewed other relevant factors such as the existing and anticipated availabilities of human resources, raw materials and production equipment and the industry's economic welfare as it affects the national security.

As has been indicated earlier today, the President did defer a final decision on this case until the Departments of Defense and Commerce have completed analysis of the projected effects of the Bearing Action Plan. As also was indicated, that analysis is to be completed by November 21, of this year.

Once the President has reached a final decision in this case, an unclassified version of the section 232 report will be published, and we would then be happy to discuss it in greater detail with the Committee. Now the Department of Commerce is charged with the responsibility of enforcing the unfair trade laws with respect to antidumping and countervailing duty investigations, and we currently have underway some 55 investigations covering products from 9 countries. The countries involved are Japan, Singapore, Thailand, Sweden, Romania, France, Italy, West Germany, and the United Kingdom.

There are some fundamental characteristics of the AD and CVD process that I would like to just touch on briefly. And that is that the process is a regulatory, quasi-judicial process in which all sides, the U.S. domestic industry and the respondent governments or the respondent foreign firms, have a full opportunity to participate in the process.

Our determinations are made on the basis of a full administrative record based on effective advocacy by both sides to the proceeding, and based on verified information developed for the record of each case. In sum, the antidumping law is designed to remedy the unfair trade practice of selling in the United States at an unfair price compared to a sale in an international market.

Senator D'AMATO. Let me ask you something. You have been undertaking this investigation for how long?

Mr. BERGAN. The petition was filed by the domestic industry on March 31 of this year.

Senator D'AMATO. When do you anticipate a conclusion?

Mr. BERGAN. The preliminary determinations in the countervailing duty cases were issued on August 29. The preliminary determinations in the 45 antidumping investigations are due on October 27.

Senator D'AMATO. What about your finding on August 29. What did you find?

Mr. BERGAN. We did find that firms received benefits, subsidies from Singapore and Thailand. I want to be accurate here. I believe, yes, there was a net subsidy found on bearings imported from

Singapore of 2 percent and bearings from Thailand of nearly 18 percent.

Senator D'AMATO. What are some of the remedies that would be available if that is the ultimate conclusion? A fine?

Mr. BERGAN. The remedy which will be available, Senator assuming a final determination is made finding dumping, is that antidumping duties will be assessed and collected by the Customs Service in the amount of the margin.

Senator D'AMATO. Retroactively?

Mr. BERGAN. It will be retroactive in the sense that the goods will already have entered the United States, but they will not have been liquidated under Customs procedures. So the duties will still be collectible.

Senator D'AMATO. Again, we are in a Catch 22, are we not? You do not have much domestic production left. You are just going to raise the cost. Is that not interesting?

Mr. BERGAN. The dumping laws are rather rigid and lacking in discretion in their implementation.

Senator D'AMATO. I am not opposed to them. I am just making an observation as someone who is not an expert in this area, and I am being educated by you gentlemen today.

Are those Singapore and Thailand firms Japanese owned?

Mr. BERGAN. I believe at least one of the firms involved in each of those countries is a subsidiary of a Japanese corporation.

Senator D'AMATO. So the conspiracy just continues. It grows and grows. That is my conclusion. I can make that judgement. You cannot, but I can. I can make those assumptions. Go ahead, Mr. Bergan.

Mr. BERGAN. To conclude my basic comments on the antidumping and countervailing duty investigations, there are basically two points that I would like to make.

One is that the proceedings involve a substantial amount of trade. We estimate roughly $500 million last year, on all the bearings cases, all the bearings products covered under the 55 cases.

Senator D'AMATO. Those are the cases that you are looking into involved $500 million.

Mr. BERGAN. That is correct.

Senator D'AMATO. How much is the ball bearing industry case, if you do know?

Mr. BERGAN. I do not have that off the top of my head, but if you wish, we can attempt to provide that information.

Senator D'AMATO. I would appreciate that.

[Material follows:]

Question. Mr. Bergan, your statement indicates that U.S. imports of all the antifriction bearing products currently subject to antidumping and countervailing duty investigations amounted to approximately $500 million last year. Could you provide the corresponding number with respect to ballbearings?

Answer. Because of the way our import statistics are reported, it is difficult to provide a very reliable number. However, we estimate that the corresponding value for 1987 ballbearing imports would amount to approximately $328 million.

Mr. BERGAN. As a result of the high volume of trade and the importance of the industry and the time constraints under which we operate by statute, we have devoted considerable resources and priority to these investigations within the Department. We are proud of our record of not having missed a statutory deadline in our antidumping and countervailing duty proceedings since the proceedings were transferred from Treasury in 1980, and we fully intend to meet our timetable at this point.

The last point that I would make is that the timing of our investigations is largely determined by the domestic industry when it files its cases. The investigations involve, in essence, a snapshot of the current market activity. We believe that is best judged by the business people in the market itself, and they can then time their filing of the cases individually or collectively covering a greater number of countries and products which then entitles them to our investigation and its conclusion within a time period covered by the statute.

With that, Senator, I would be willing to conclude my summary and attempt to answer any questions you or the other Members of the Committee may have.

[The- prepared statement of Mr. Bergan follows:]

STATEMENT OF

TIMOTHY N. BERGAN

DEPUTY ASSISTANT SECRETARY OF COMMERCE

FOR IMPORT ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

September 8, 1988

Thank you, Mr. Chairman and members of the Committee. I appreciate this opportunity to discuss with you the problems facing one of the United States' most critical industries. In my statement today, I will update you on the status of the Department's Section 232, antidumping and countervailing duty investigations concerning antifriction bearings. I would like to begin, however, by reviewing with you the importance and current condition of the U.S. bearing industry.

Importance and Condition of the U.S. Bearing Industry

The bearing industry is an essential element of the U.S. manufacturing base, particularly because antifriction bearings have widespread applications in virtually all industrial products with moving metal parts. There is no doubt that an economically healthy, technologically advanced bearing industry is also critical to our defense preparedness and overall national security. Bearings are needed in military products as basic as motor vehicles and as sophisticated as missile guidance systems. Overall, the consumption of bearings by the military -- both directly and indirectly -- accounts for about one-fifth of total U.S. consumption. In the event of a major national security crisis requiring a surge or mobilization of U.S. defense-related manufacturing, the inability to procure the needed bearings in a timely manner could bring industrial mobilization to a virtual standstill.

At present, the domestic bearing manufacturing industry is operating near full peacetime capacity, and we consider this to be a positive development. However, it is important to note that, during the last decade, the domestic bearing industry encountered economic difficulties which led to a significant contraction of production capacity. This industry still faces major challenges from foreign competition, particularly from large European and Japanese bearing corporations with extensive international operations. In recent years, these foreign competitors have consolidated their holds on their own home markets while turning their attention increasingly to the United States market.

In light of these challenges, let me take just a moment to go over some of the major trends now occurring in the U.S. bearing industry.

- Domestic shipments (in constant 1987 dollars) have declined from a high of $4.6 million in 1979 to $3 billion in 1987.
- Employment has declined from a high of 58,000 workers in 1979 to 43,000 workers in 1987.
- Profitability (net before taxes) declined from a high of 9.3 percent of sales in 1980 to 3.6 percent in 1986 (the last year for which complete data is available), even though it has remained above the levels reported by other general and special industrial machinery producers.
- Since the late 1970s about 30 plants -- accounting for over $1 billion in annual production capacity -- have closed. These facilities primarily produced ball and tapered roller bearings. Their closure was largely attributable to stiff foreign price competition and increased imports of manufactured products containing embedded bearings, such as automobiles.

- These generally negative economic trends have led to increased foreign penetration of the U.S. market in some product lines. In this industry, import penetration levels vary significantly. For example, in 1987, volume import penetration levels varied from as low as 6 percent for superprecision bearings over 100mm in diameter to as high as 78 percent for regular precision ball bearings under 30mm in diameter.

- In addition, U.S. bearing producers are relying increasingly on foreign-sourced inputs. For example:

  1. About half of the U.S. bearing industry depends to varying degrees on imported steel as a manufacturing input in their finished bearing products. A number of companies have told us that this foreign dependence is a matter of necessity rather than choice, due to limited supplies of domestic specialty steels.

  2. Furthermore, a number of U.S. bearing manufacturers depend on imports of bearing components to produce finished bearing products.

Taking these factors into account, the Administration has devoted considerable attention to an analysis of the bearing industry's problems. In response, the Administration, through the Department of Defense, has developed a Bearing Action Plan which is intended to improve the antifriction bearing industry's ability to meet national security requirements. Included in the Plan are Federal Acquisition Regulations to require domestic procurement of all defense-related bearings. In addition, the Plan includes steps designed to facilitate modernization of the bearing industry and to integrate domestic bearing manufacturers more fully into the defense procurement process.

Section 232 Investigation

The Department of Commerce has also conducted a comprehensive investigation under section 232 of the Trade Expansion Act of 1962 concerning the effect of bearing imports on the national security. Secretary Verity forwarded the Department's Section 232 report on antifriction bearings to the President on July 15, 1988.

The focus of this report dealt with the effect of imports on the domestic industry's ability to meet national security requirements in the event of a major conventional war. This included an analysis of the domestic production needed to support defense and essential civilian demand for bearings and the capacity of the domestic bearing industry (as well as reliable imports) to meet that demand. We also reviewed other relevant factors, such as the existing and anticipated availabilities of human resources, raw materials and production equipment, and the industry's economic welfare as it effects the national security.

President Reagan has studied the Secretary's findings and recommendations and has decided to defer a final decision in this case until the Departments of Commerce and Defense have completed an analysis of the projected effects of the Bearing Action Plan. The President has asked that this analysis be concluded by the end of the year. Once the President has reached a final decision in this case, an unclassified version of the Section 232 report will be published which we would then be happy to discuss in greater detail.

AD/CVD Investigations

Imports of antifriction bearings are also the subject of an unfair trade complaint filed on behalf of the U.S. bearing industry on March 31, 1988. Currently, 45 antidumping (AD) and 10 countervailing duty (CVD) investigations are under way involving imports of various types of bearings and bearing parts from Japan, Singapore, Thailand, Sweden, Romania, France, Italy, West Germany and the United Kingdom. Before I fill you in on the status of these investigations, it might first be useful to explain briefly what the AD and CVD laws are intended to address and how they operate.

At the outset, it is important to understand the fundamental characteristics of the AD/CVD process. Essentially, it is a regulatory, quasi-judicial process in which determinations of unfair trade and injury are reached through the course of adversarial proceedings and on the basis of verified information developed for the record of each case.

Briefly, the AD law is designed to offset the effects of the unfair pricing -- or "dumping" -- of imported goods in our market. Dumping occurs when foreign firms sell at a lower price in the United States than in their home or other export markets or, in some cases, when they sell the product here for less than their cost to produce it. Under the AD law, the intent of the foreign firm in setting its prices is never relevant to our determinations of whether dumping exists.

In a similar fashion, the CVD law works to offset the unfair advantage arising from foreign government subsidization of goods sold in the United States. Examples of unfair subsidies we often countervail include tax benefits contingent upon exporting or government- provided low cost loans targeted to specific companies or industries.

An AD or CVD investigation is typically begun when a petition is filed with Commerce and the International Trade Commission (ITC) by or on behalf of an affected U.S. industry. By law, such petitions must allege unfair, injurious competition either from dumped or subsidized imports, and be supported by reasonably available information. Commerce will then determine whether dumping or subsidization exists and, if so, the amount. These determinations are reached through sending questionnaires to the foreign companies and/or government involved, analyzing and conducting on-site verifications of the responses, holding hearings, and considering written comments and arguments made by the interested parties.

In cases where foreign companies or governments do not respond to our questionnaires, or when they provide inadequate or inaccurate responses, the law authorizes us to use the best information otherwise available. We have the authority to make adverse assumptions using whatever information may be on the record, which is often the information supplied by the petitioner. As a result, respondents have a clear incentive to be forthcoming with us.

In most cases, the ITC will also conduct a parallel investigation of whether the imported merchandise causes or threatens material injury to a U.S. industry, or materially retards the establishment of an industry. Commerce and ITC both make preliminary and final determinations with respect to unfair trade and injury. If both agencies' final determinations are affirmative, antidumping or countervailing duties are imposed to offset the amount of unfair trade which was found. Under normal circumstances, it takes about seven months to complete a CVD investigation and nine months to bring a dumping case to conclusion.

The current investigations on antifriction bearings were initiated on April 20, 1988, on the basis of a petition filed by the Torrington Company on behalf of the U.S. bearing industry. The scope of these investigations encompasses virtually all types of bearings and bearing parts with the exception of tapered roller bearings, which have already been investigated and found to have been unfairly traded. U.S. imports of the products under investigation amounted to about $500 million last year. The foreign companies involved include several large multinational corporations such as SKF, FAG, INA, Koyo Seiko and Minebea.

On August 29, we issued our preliminary determinations in the 10 countervailing duty investigations involving bearings from Singapore and Thailand. For Singapore, we preliminarily found a net subsidy of 2.01 percent for all manufacturers or exporters of bearings, with the exception of one producer who did not respond and thus received a rate of 4.95 percent based on the best information otherwise available. Bearings imported from Thailand were preliminarily found to benefit from a net subsidy of 17.83 percent.

The preliminary determinations in the antidumping investigations have been postponed until no later than October 27, 1988. The statute provides for AD investigations to take a little longer than CVD cases, in part because we have to obtain information from what can sometimes be a large number of individual companies. We have found these cases in particular to be extraordinarily complicated, largely due to the vast number of sales transactions.

As I noted earlier, in 1987 the Department issued six AD orders imposing antidumping duties on imports of tapered roller bearings from Japan, Italy, Romania, Hungary, Yugoslavia and the People's Republic of China (PRC). In these investigations, the Department found that imported tapered roller bearings were being dumped by weighted-average margins of 0.97 percent for the PRC, 7.42 percent for Hungary, 8.70 percent for Romania, 33.61 percent for Yugoslavia, 36.52 percent for Japan and 124.75 percent for Italy.

As you can see, Mr. Chairman, the Department of Commerce takes very seriously its responsibilities to administer these trade laws in a vigorous and effective manner. We will continue to do all we can to ensure that the domestic bearing industry remains a viable part of our industrial economy.

Thank you, Mr. Chairman. I would now be happy to take any questions you or the other Committee members may have.

Questions Submitted by Senator Lowell Weicker, Jr.
for Timothy N. Bergan

Question:

Mr. Bergan, a 1986 DOD study on the bearing industry, which the Commerce Department helped prepare, recommended that Commerce establish a panel to address the underlying issues that are causing the deterioration and erosion of the U.S. bearing industry. Among the issues that the panel should address was the temporary limiting of imports, examining the antidumping regulations for their ability to discourage dumping, and the benefits of financial and tax incentives to encourage greater investment within the domestic manufacturing industry.

Has Commerce convened such a panel and considered any of the recommended issues?

Answer:

The Department has not convened such a panel because of overtaking events. The Section 232 investigation and the DOD Bearing Action Plan address the issues that were suggested for review by the Joint Logistics Commanders Study. We therefore believed that the work of any such panel would largely be duplicative of activities already under way.

Question:

Mr. Bergan, you have heard Customs Commissioner von Raab describe the investigation of the Minebea Corporation. The Committee understands that Commerce has been offered access to evidence in the investigation. Have you determined whether this information would be useful yet? Why have you waited until September 6, this week, to formally ask for copies of this information?

The Congressional Research Service has provided the Committee with an analysis finding no statutory restrictions of the abilities your Department has in utilizing such information. I would like to submit it for the record. Would you like to comment on this analysis?

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

September 6, 1988

TO : Senate Committee on Small Business
Attention: Tim Osborn

FROM : American Law Division

SUBJECT : Scope of the Department of Commerce's Authority to Accept and Use Third-Party Information in Antidumping Proceedings

This memorandum responds to your request for an analysis of the scope of the Department of Commerce's authority to accept and use information in antidumping proceedings that is made available by other government agencies. You have asked whether the Department has statutory authority to do this and, if so, whether there are any constraints or limitations on its power, such as statutory provisions governing the confidentiality of information so received. For reasons discussed below, it would seem that existing statutory authority does not preclude the Department from accepting and using such information, although Department practice and other considerations may make it reluctant to do so in particular situations.

The current antidumping statute, which is found in Title VII of the Tariff Act of 1930, 19 U.S.C. §§ 1673 et seq., was enacted in the Trade Agreements Act of 1979, Pub L. No. 96-39, Title I, which also repealed its predecessor, the Antidumping Act, 1921. Section 731 of the Tariff Act of 1930 (TA), 19 U.S.C. § 1673, provides that imports will be subject to antidumping duties where the Department of Commerce (DOC) determines that they are being, or are likely to be, sold in the United States at less than their fair value (LTFV) and the International Trade Commission (ITC) determines that a United States industry is materially injured, or threatened with material injury, or its establishment is being materially retarded, by reason of those imports. Once the DOC decides to proceed with an antidumping petition, it must initiate an LTFV investigation, TA § 732(c), 19 U.S.C. § 1673a(c), and so notify the ITC, TA § 732(d), 19 U.S.C. § 1673a(d)(1). The DOC and ITC must each make preliminary and final determinations with respect to the matters within their jurisdiction within statutory time periods; extensions are authorized for "extraordinarily complicated" cases and retroactive suspension of liquidation is to be imposed where "critical circumstances," that is, import surges, are found to exist. See generally, TA §§ 733, 735; 19 U.S.C. §§ 1673b, 1673d.

There are several provisions within the Tariff Act that specifically deal with information and its treatment in antidumping proceedings. For example, § 732(d)(2), 19 U.S.C. § 1673a(d)(2) provides that once the DOC determines that a petition alleges the elements necessary for the imposition of antidumping duties and contains information reasonably available to the petitioner supporting the allegations, the Department must, along with commencing an investigation, make available to the ITC "such information as it may have relating to the matter under investigation, under such procedures as the administering authority and the Commission may establish to prevent disclosure, other than with the consent of the party providing it or under protective order, of any information to which confidential treatment has been given by the ... [DOC]." In addition, the Act requires the DOC to base its preliminary determination, that is, "whether there is a reasonable basis to believe or suspect that ... merchandise is being sold, or likely to be sold at less than fair value," on the "best information available to it at the time of the determination." TA § 733(b)(1), 19 U.S.C. § 1673b(b)(1). The "best information available" standard is also applicable to the DOC's "critical circumstance" determinations, which must include findings of whether there is a reasonable basis to believe or suspect that there is a history of dumping of the subject merchandise in the United States, the importer knew or should have known that the exporter was making LTFV sales, and there have been massive imports of the subject merchandise over a relatively short period. TA § 733(e), 19 U.S.C. § 1673b(e). Provisions similar to § 732(d)(2), supra, regarding information that must be made available to the ITC and how such information should be protected. exist with respect to information used by the DOC in making its preliminary and final determinations. TA §§ 733(d)(3), 735(c)(1)(a); 19 U.S.C. §§ 1673b(d)(3), 1673d(c)(1)(A). Section 776 of the Tariff Act, 19 U.S.C. § 1677e, provides that except for information whose verification is waived under § 733(b)(2), 19 U.S.C. § 1673b(b)(2),[1] the DOC must verify all information it relies upon in making a final determination (as well certain determination regarding administrative reviews of existing antidumping and countervailing duty orders) and use the best information available as the basis for its determination where it is unable to verify the accuracy of the information submitted, including information submitted in support of the petition; in addition, in making any determinations, both the

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[1] Under this provision, the DOC must, within 75 days of beginning an investigation, have a designated individual review the information received during the first 60 days of the investigation and, if there appears to be sufficient information upon which a preliminary determination may reasonably be based, disclose to the petitioner any interested party who is then a party to the proceedings and requests such disclosure, all available nonconfidential information and all other information disclosed under § 777 of the Tariff Act, 19 U.S.C. § 1677f, relating to access to information. The petitioner and each interested party (as defined in Tariff Act, § 771(9)(C)-(E), 19 U.S.C. § 1677(9)(C)-(E)) to whom disclosure is made may furnish to the DOC an irrevocable written waiver of verification of the information that the DOC received, and an agreement that it is willing to have preliminary determination made on the basis of the record then available to the Department.

DOC and the ITC must use "the best information otherwise available" in any case where "a party or any other person refuses or is unable to produce information requested in a timely manner and in the form required, or otherwise significantly impedes an investigation."[2]

Section 777 of the Tariff Act, 19 U.S.C. § 1677f, sets forth detailed provisions regarding access to information used in antidumping proceedings. In enacting the provision, Congress was aware that antidumping and countervailing duty petitioners had "long contended that their ability to obtain relief ... [had] been impaired by ... [their] lack of access to the information presented by the exporters and foreign manufacturers," and, at the same time, that "importers, exporters, and other respondents in such cases ... [had] complained of lack of access to information supplied by the domestic parties to such cases, particularly with respect to the economic health of the domestic industry involved." S. Rep. No. 249, 96th Cong., 1st Sess. 100 (1979) [hereinafter cited as 1979 Senate Report]. The provision was thus intended to bring a certain amount of transparency to these proceedings by providing "the maximum availability of information to interested parties consistent with the need to provide adequate protection for information accorded confidential treatment." _Id._ _See generally_, Pattison, _Antidumping and Countervailing Duty_

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[2] There would seem to be at least two types of "best information available" standards at work: one serving as a less stringent standard for decision-making where information is otherwise unavailable (and thus acting as a means of inducing recalcitrant parties to provide information to the DOC), the other constituting a mandate for thorough investigations. See _Budd Co. Ry. Div. v. United States_, 507 F. Supp. 997 (Ct. Int'l Trade 1980), discussed _infra_. The latter standard, which is applicable to preliminary determinations, TA § 732, 19 U.S.C. § 1673a, would seem to affect the quality of final determinations as any information acquired at the preliminary stage would presumably be available throughout the proceeding. It would seem difficult to argue that only the first "best available information" standard, and not the second, is applicable at the final stage, given the legal impact of this determination and the presumably remedial nature of the antidumping statute.

Laws § 7.01 (1988).

The section allows the DOC to disclose "any proprietary information received in the course of a proceeding if it is disclosed in a form which cannot be associated with, or otherwise be used to identify, operations of a particular person," and "any information submitted in connection with a proceeding which is not designated as proprietary by the person submitting it." TA § 777(a)(4), 19 U.S.C. § 1677f(a)(4).[3] Except for proprietary information not associable with particular persons, information submitted to the DOC that is designated as proprietary by the person submitting it may not be disclosed, without that person's consent, to any person other than an officer or employee of the DOC or ITC who is directly concerned with carrying out the investigation in connection with which the information is submitted, or an officer or employee of the United States Customs Service who is directly involved in conducting an investigation regarding fraud involving dumped or subsidized imports. TA § 777(b)(1), 19 U.S.C. § 1677f(b)(1). The information for which proprietary treatment is requested must be accompanied by either a non-proprietary summary or a statement explaining why it is not susceptible to the same, and by either a statement permitting the DOC to release under administrative protective order (APO) the information submitted in confidence, or a statement that the information should not be released under APO. Id. The DOC may determine, based on the nature and extent of the information or its availability from public sources, that designation of the information as proprietary is unwarranted, and if it is not further persuaded to the contrary by the party submitting it, must return it to that party. TA § 777(b)(2), 19 U.S.C. § 1677f(b)(2). Upon receiving an application, the DOC may make proprietary information submitted by any other party to the proceeding available under a protective order that contains requirements that the DOC, by regulation, deems appropriate and whose violation is subject to sanctions. TA § 777(c)(1), 19 U.S.C. § 1677f(c)(1).[4] If the DOC denies a request for

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[3] Under its regulations, the DOC maintains an official record of all proceedings, which includes materials protected from disclosure, non-confidential material submitted by any person other than an employee or officer of the United States Government, and non-confidential and non-privileged material submitted or developed by an employee or officer of the United States Government. 19 C.F.R. § 353.25(a). DOC regulations regarding access to information in antidumping proceedings are set forth at 19 C.F.R. §§ 353.25 through 353.31.

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[4] Congress intended that the DOC's authority to make limited disclosure of proprietary information be a "specifically authorized exception" to the Trade Secrets Act, 18 U.S.C. § 1905, which penalizes the disclosure by United States officers and employees of confidential information that comes to them in the course of their employment "in any manner and to any extent not authorized by law." S. Rep. No. 249, 96th Cong., 1st Sess. 100 (1979); H.R. Rep. No. 317, 96th Cong., 1st Sess. 78 (1979). The application of § 1905 to interagency transfers is discussed infra.

It was also Congress' intent that the limited disclosure allowed under § 777 not result in any requirement for general disclosure under the Freedom of Information Act (FOIA). S. Rep. No. 249 at 100-101; H.R. Rep. No. 317 at 78. FOIA does provide, however, that its requirements are inapplicable to matters that are, inter alia, "specifically exempted from disclosure by statute ... provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld," 5 U.S.C. § 552(b)(3), and "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. § 552(b)(4). The United States Court of Appeals for the District or Columbia Circuit recently held that § 777 qualifies as a withholding statute that triggers the FOIA exemption set forth at 5 U.S.C. § 552(b)(3), discussed above. Mudge Rose Guthrie Alexander & Ferdon v. United States Int'l Trade Comm'n, 846 F.2d 1527 (D.C.Cir. 1988).

The same court has also ruled on the relationship of the Trade Secrets Act to these two exemptions. On one hand, it has held that the Trade Secrets Act, because of its "encyclopedic character and absent any limitation as to the agencies covered or the sources of data involved," may not be treated as a general withholding statute under § 552(b)(3). CNA Financial Corp. v. Donovan, 830 F.2d 1132 (D.C.Cir. 1987), cert. denied, 108 S.Ct. 481 (1988); see also 830 F.2d at 1141, n.62 for a list of cases concluding the same. A contrary conclusion was reached in Westinghouse Electric Corp. v. Schlesinger, 542 F.2d 1190 (4th Cir. 1976), cert. denied, 431 U.S. 924 (1977), although the Fourth Circuit may have since, at least impliedly, changed its view. See 830 F.2d at 1141, n. 62, citing General Motors Corp. v. Marshall, 654 F.2d 294, 297 & n.9 (4th Cir. 1981). The CNA court reconciled FOIA and the prohibition on proprietary information, the requesting party may then apply to the United States Court of International Trade for an order directing the DOC to make the information available. TA § 777(c)(2), 19 U.S.C. § 1677f(c)(2); *American Spring Wire Corp. et al. v. United States*, 4 C.I.T. 210 (1982). The Court may issue an order directing the DOC to make the information available under a protective order if the former finds that, under the standards applicable in proceedings of the court, such an order is warranted, and that the DOC has denied access to the information where requested by application under 19 U.S.C. § 1677f(c)(1), the person on whose behalf the information is requested is an interested party who is a party to the investigation in connection with which the information was obtained or developed, and the party who submitted the information to which the request relates has been notified, in advance of the hearing, of the request made under the section, and of its right to appear and be heard. TA § 777(c)(2), 19 U.S.C. § 1677f(c)(2). Information provided to the DOC by foreign governments is exempt from disclosure under APO. 19 C.F.R. §§ 353.30, 355.21 (1988); Exec. Order No. 12356, 47 Fed. Reg. 14874 (1982).[5] *See generally*, Taylor & Vermulst, "Disclosure of Confidential Information in Antidumping and Countervailing Duty Proceedings Under United States Law: A Framework for the European Communities," 21 *Int'l Law.* 43 (1987)[hereinafter cited as *Taylor & Vermulst*]; Stred, "International Trade: Court of

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disclosure that the Trade Secrets Act would still seem to require regardless of its status under the former by characterizing the Trade Secrets Act as "one of those prior-existing nondisclosure edicts that have been at least partially superseded by FOIA's newer public access mandate ... " 830 F.2d at 1141. At the same time, however, the court ruled that the Trade Secrets Act is "at least co-extensive with that of Exemption 4 of FOIA." 830 F.2d at 1151; *see also* cases cited at 1151, n. 138.

[5] Such information is present more often in countervailing duty proceedings, where allegations of foreign government subsidies are involved.

International Trade Disclosure of Confidential Information," 24 Harv. Int'l L. Rev. 219 (1983).

There appear to be no provisions in the Tariff Act provisions governing antidumping proceedings that speak expressly to the DOC's authority to obtain and use information from agencies that are not charged with specific functions under the antidumping statute. It may be argued, however, that § 733 of the Tariff Act, 19 U.S.C. § 1673b, which requires that preliminary determinations be made on the best information available to the DOC at the time of its determination, serves as an agency mandate to obtain information that pertains to an investigation at hand from any source. In at least one instance, the Court of International Trade viewed a similar provision applicable to the ITC as placing a duty on the investigating agency to conduct a vigorous investigation at the preliminary stage. In Budd Co. Ry. Div. v. United States, 507 F. Supp. 997 (Ct. Int'l Trade 1980), a case involving a challenge of ITC negative preliminary injury determinations in an antidumping investigation, the Court cited TA § 733(a), 19 U.S.C. § 1673b(a), regarding the use of "best information available" in preliminary injury determinations, and TA § 776(b), 19 U.S.C. § 1677e(b), regarding the use of "best information otherwise available" when parties do not submit requested information at the final determination stage, as evidence of Congress' expectation that the Commission "take an active role in obtaining information prior to its determination" and as "clearly express[ing] the congressional intent that the Commission will obtain information through its own investigative sources." 507 F. Supp. at 1000-1001. The Court rejected the government's argument, based on language in the Senate report accompanying the Trade Agreements Act of 1979, that the "reasonable indication" of injury language in § 733 placed on the petitioner the burden of proof of all facts necessary to establish a reasonable indication of a material injury or threat thereof, and took a broad view of where information might be obtained:

> Whatever significance the foregoing [report] statement should receive, it is manifest that the term "burden of proof" used in an investigative proceeding does not have the same meaning as when used in an adjudicatory proceeding. Clearly, in the latter instance the bearer of this burden would have a more extensive means of obtaining information to satisfy that burden.
>
> It is the opinion of this court that the oblique reference to "burden of proof" contained solely in the Senate Committee Report can neither qualify or immunize the duties or obligation imparted by the explicit language of the statute and the legislative history charging the Commission to make its preliminary determination on the "best information available." It must be emphasized that this mandate does not limit "the best information available" to that furnished by the petitioner or by any party-in-interest to the proceedings. The term "available" as used in the statute must be construed in accordance with its common meaning. In so doing, it is clear that all information that is "accessible or may be obtained," from whatever its source *must be reasonably sought by the Commission*. It is only in this manner that the Commission comply with the intended congressional mandate to conduct a "thorough investigation." 507 F. Supp. at 1003-1004 (emphasis added).

The Trade Agreements Act (TAA) had placed the ITC in a new position with respect to antidumping proceedings in that United States law now contained provisions for DOC petition and ITC preliminary injury determinations that presumably made the antidumping statute consistent the GATT Antidumping Code, which requires consideration of both injury and LTFV sales before an antidumping investigation is initiated. *See* 1979 Senate Report at 66. Under the statute, the ITC has 45 days within which to make its determination and, unlike prior law, must make such a determination in every case; both the Senate and House reports on the TAA note that the 45-day period is a brief one but still contemplate that the ITC will undertake a "thorough" investigation. 1979 Senate Report at 66; H.R. Rep. No. 317, 96th Cong., 1st Sess. (1979) [hereinafter cited as 1979 House Report]. As stated in the House report:

> The time limit provided in the bill for an ITC preliminary determination, although longer than that under present law, is still quite brief. It is therefore intended that the ITC will investigate the allegations in the petition in as thorough a manner as possible using the information available within that time period, and will provide interested parties a reasonable opportunity to present their views. Such opportunity does not necessarily include a hearing such as that required prior to a final determination. Id.

The Budd court cited this language, 507 F. Supp. at 1000-1001, along with a Senate report statement that the nature of the ITC's inquiry "may vary from case to case depending on the nature of the information available and the complexity of the issues." 1979 Senate Report at 66, quoted in 507 F. Supp. at 1000-1001.

While Budd Co. involved a congressional mandate specifically directed at the ITC, and the court, in interpreting the statute, took note of, not only this mandate, but also the fact that the ITC has its own statutory subpoena power to seek both confidential and non-confidential information, 507 F. Supp. at 1001-1002, one may nonetheless argue that the breadth of the "best information available" language construed in Budd Co. is not limited to ITC preliminary determinations, but applies as well to the DOC. The statutory mandate is identical with respect to both agencies. TA §§ 733(a),(b)(1), 776(b); 19 U.S.C. §§ 1673b(a,(b)(1), 1677e(b). Although there does not appear to be any similar report language directed at the DOC, it is possible that Congress did not need to describe the Department's role in the same way it described that of the ITC inasmuch as the Department had already been charged with making preliminary LTFV determinations with a then 6-month deadline. Antidumping Act, 1921, § 201(b)(1). Further, the fact that a "thorough" investigation is expected of an agency that has 45 days in which to make a preliminary determination would seem to indicate that the same might well be contemplated for an agency that has 160 days to do so. See TA § 733(b)(1), 19 U.S.C. § 1673b(1). In addition, the availability of subpoena power would not seem to be relevant in determining the scope of an agency's authority to acquire information from another government agency where that information is made available voluntarily and is not otherwise legally encumbered. It may also be noted that the court used both "best information available" standards to support its conclusion that the Commission was charged with conducting a thorough investigation at the preliminary stage and arguably implied that such a standard exists at all stages of an antidumping proceeding.

Even though Congress seemingly intended that agencies accept information in antidumping proceedings from a broad range of sources, it is possible that the Department may nevertheless be reluctant to do so where that information may be proprietary in nature. Where a party to the proceeding provides information to the Department and requests that it be deemed proprietary, the statute sets forth specific procedures for the disposition of that request, allows for limited disclosure where information is granted proprietary treatment, and provides for the possibility of court-ordered disclosure where the Department has refused a disclosure request. TA § 777, 19 U.S.C. § 1677f. In providing that information is generally not to be disclosed where it is designated as proprietary "by the person submitting it," and given the nature of the information at issue (e.g., information regarding profits, production costs, volume of sales, prices, customer names, return on investment), the statute would seem to be directed at business firms. At the same time, an agency possessing information useful to another agency might consider it to be proprietary at the outset for purposes of the Trade Secrets Act, 18 U.S.C. § 1905. That statute provides as follows:

> Whoever, being an officer or employee of the United States or of any department or agency thereof, publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information coming to him in the course of his employment or official duties or by reason of any examination or investigation made by, or return, report or record made to or filed with, such department or agency or officer or employee thereof, which information concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association; or permits any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; shall be fined not more than $1,000, or imprisoned not more than one year, or both; and shall be removed from office or employment.

Some case law suggests, however, that the Trade Secrets Act may be inapplicable to interagency transfers of information. While the Act has in at least one instance been assumed to apply in this situation, Shell Oil Co. v. Dep't of Energy, 477 F. Supp. 413, 432 (D. Del. 1979), a federal appeals court has concluded that the Trade Secrets Act was intended to apply only to public disclosures of trade secret material and not to prohibit transfers between agencies. Emerson Electric Co. v. Schlesinger, 609 F.2d 898, 907 (8th Cir. 1979); see also Interco, Inc. v. Federal Trade Comm'n, 490 F. Supp. 39 (D.D.C. 1979)(holding that release of information containing trade secrets by the FTC to state attorneys general was not a public disclosure and was thus "authorized by law" for purposes of the Trade Secrets Act); Ashland Oil v. Federal Trade Comm'n, 548 F.2d 977 (D.C. Cir. 1976)(upholding the authority of the FTC to transmit confidential information to Congress under § 6(f) of the Federal Trade Commission Act, 15 U.S.C. § 46(f)); and infra, n.7. The Supreme Court has also made it clear that the Act does not preclude transfers where they are authorized either by statute or by properly issued agency regulations having a reasonable relationship to the purpose and scope of a statutory grant substantive rulemaking authority. Chrysler Corp. v. Brown, 441 U.S. 281, 301-316 (1979).[6] Recently, the United States Court of Appeals for the District of Columbia Circuit, in examining whether the scope of the Trade Secrets Act was coterminus with that of the three statutes on which it was based, appeared to indicate that the legal authorization requirement applied only to public disclosures, noting that its examination "is of much more than academic interest to federal agencies that currently do not have public access regulations qualifying as legal authorizations for disclosures otherwise prohibited by the Trade Secrets Act." CNA Financial Corp. v. Donovan, 830 F.2d at 1144 (emphasis added).

Were the Commerce Department to receive information from another agency, and assuming there were no other legal strictures on the use of the information, that information would seem to be subject to the requirements of § 777. As noted earlier, Congress intended that this provision be a specifically authorized exemption to the Trade Secrets Act. See supra, n.4. It is unclear, however, how the DOC would treat a request for disclosure of proprietary material received in this way, and research reveals no case regarding standards for disclosing information, theoretically proprietary in nature, that is provided by a federal agency rather than a party or business non-party to a proceeding.[7] The statute provides for proprietary designations by persons submitting the information, TA § 777(a)(1), 19 U.S.C. § 1677f(a)(1), and speaks to disclosure requests for information submitted by any other party to the investigation. TA § 777(c)(1)(A), 19 U.S.C. § 1677f(c)(1)(A). The same considerations that prompt a firm to request material to be treated confidentially may not be present with respect to an agency in possession of that information, especially where Trade Secrets Act questions are obviated.

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[6] Proprietary information in the possession of the DOC and ITC may be made available to officers and employees of the United States Customs Service who are directly involved in conducting investigations regarding fraud involving subsidized or dumped imports. TA § 777(b)(1), 19 U.S.C. § 1677f(b)(1). In enacting this provision, Congress intended to allow the release of such information "solely to prevent an unintended restriction from continuing. The reason for this change is to improve administration of the customs laws by increasing the likelihood that parties allegedly engaging in civil fraud will be scrutinized." H.R. Rep. No. 725, 98th Cong., 2d Sess. 44 (1984). It is unclear from the House Report whether Congress viewed the Trade Secrets Act as causing the current restriction. It might be noted, however, that to the extent that the Customs Service makes information available to other agencies under law or regulation, or does so based on the premise that the Trade Secrets Act applies only to public disclosures, the fact that Congress allowed for transfers from the DOC and ITC to the Customs Service does not seem necessarily to have implications with respect to the Service's existing authority to transfer information to other agencies.

Commerce Department regulations provide that the Department will consider information to be privileged or confidential only if its disclosure would be likely to (1) cause substantial harm to the competitive position of the person submitting it; (2) have a substantial adverse effect upon the person supplying the information or upon the person from whom the information was obtained; or (3) impair the ability of the United States Government to obtain in the future necessary information, not required by law to be provided, from the same persons or others similarly situated. 19 C.F.R. § 353.29. Among the many court decisions on information disclosure under § 777, Sacilor, Acieries et Laminoirs de Lorraine v. United States, 3 I.T.R.D. 2225 (Ct. Int'l Trade 1985), explained that "the release of confidential information must be the result of a reasoned decision which carefully evaluates the need of the applicant as opposed to the demands of confidentiality. This decision should not confuse the role and need of a party to an administrative investigation with that of a litigant in a court of law and it should not reflect an abdication of the investigative duties of the agency." Id. at 2227. In Arbed, S.A. v. United States, 3 I.T.R.D. 2369 (Ct. Int'l Trade 1982), the court found within the investigating agency "a range of discretion ... to determine the degree of exposure to confidential information consistent with the objectives of the investigation and the dictates of the law." Id. at 2372. Commentators have recently observed that the DOC's "lenient administrative attitude toward disclosure, together with the ... [Court of International Trade's] grant of administrative discretion in this field, suggests that in most cases counsel for petitioners will get access to confidential data submitted by foreign producers." Taylor & Vermulst at 51.

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[7] It is important to note that federal law requires that any agency receiving information from another agency is subject to the same legal strictures as the latter, including those provisions of law relating to the unlawful disclosure of information. 44 U.S.C. § 3510(b). This provision would seem also to imply that interagency transfer of confidential information is contemplated. See also Int'l Trade Comm'n General Cousel Memorandum GC-83-107 for a discussion of the Commerce Department's obligation to maintain the confidentiality of any such information provided to it by the ITC under § 337(b)(3) of the Tariff Act, 19 U.S.C. § 1337(b)(3), which requires the Commission to notify the Department whenever, in the course of a § 337 investigation "the Commission has reason to believe, based on information before it, that a matter, in whole or in part, may come within the purview of" the antidumping or countervailing duty laws.

We hope that this discussion will be helpful to you and that you will call on us if you have any additional questions.

Jeanne Jagelski

Jeanne Jagelski
Legislative Attorney
American Law Division

Answer:

We are continuing to analyze whether the Department lawfully may use in its antidumping investigation the material received by our Office of General Counsel under seal on September 6 and, if so, whether such information is relevant to the Department's investigation.

As to the timing of our request for the information, following our initial analysis of the legal issues raised by transfer of the fraud investigation material to the Department of Commerce, we sought assurances from the Commissioner of Customs that our receipt of these materials would not jeopardize the Customs Service's ongoing fraud investigation. We received such assurances on September 1, and immediately requested a copy of the material.

The September 6 opinion from the Congressional Research Service (CRS) recognizes that the Department may be reluctant to make this information a part of its antidumping investigation record, because the antidumping law makes no provision for release to the parties in such an investigation of proprietary material obtained under the circumstances presented here (p. 11, CRS report). The report goes on to say:

> It is unclear, however, how the DOC would treat a request for disclosure of proprietary material received in this way, and research reveals no case regarding standards for disclosing [such] information....

(pp. 13-14, CRS report). We are continuing to study the unique and difficult issues presented by these facts and will make full use of the helpful CRS analysis in doing so.

Question:

Mr. Bergan, in submitting the 232 petition report to the President, did Commerce recognize the need for a strong commercial bearing industry in order to provide the resources to meet our defense needs?

Answer:

The Department recognizes that the full range of regular precision and superprecision bearings are needed for national security purposes. Bearings are needed in all metal products with moving parts, and therefore are necessary for manufacturing defense products as common as motor vehicles and as sophisticated as high accuracy gyroscopes for missile guidance systems.

Question:

Mr. Bergan, your office is an expert on the bearing industry. In your opinion, are domestic producers competing on a level playing field?

Answer:

As I pointed out in my written statement, the domestic bearing industry has experienced some difficult economic changes over the past decade, many of which stemmed from stiff foreign competition. Whether the competitive "playing field" has been level during this period will be answered in part through the results of the antidumping and countervailing duty investigations now under way.

Certainly, the estimated subsidy margins found against Singapore and Thailand suggest that unfair trade practices have played a role, but bear in mind that these determinations were only preliminary. In any event, I can assure you that the Department is vigorously investigating the allegations of injurious dumping and subsidization. If unfair trade is confirmed, it will be fully offset through the assessment of antidumping and countervailing duties.

Question:

What kind of message will it be to domestic producers if the President does not act to protect domestic manufacturers and our national security?

Answer:

The President will make his decision based on the comprehensive analysis conducted in the Section 232 investigation, as well as upon the supplemental report that we will provide him. The White House will offer a complete explanation of the President's decision when it is made. It would be inappropriate to attempt to comment now on a decision that has not yet been reached.

Question:

A number of reports have provided ample evidence on the deterioration of the domestic bearing industry and its importance to national security. Why didn't Commerce initiate its own 232 investigation instead of relying on the industry to act?

Answer:

After the release of the Joint Logistics Commanders Study, the bearing industry informed us that they intended to submit a petition under Section 232. We therefore determined it would be more appropriate to move forward with an investigation on the basis of the industry's petition.

Senator D'AMATO. Mr. Mercer.

STATEMENT OF LEE W. MERCER, DEPUTY UNDER SECRETARY OF COMMERCE FOR EXPORT ADMINISTRATION

Mr. MERCER. It is a pleasure to be here today, but not a pleasure to listen to the stories about the domestic bearing industry. As you have heard, our organization, the Bureau of Export Administration, will be reassuming authority over the 232 investigation.

Under Secretary Paul Freedenberg is on official travel today, but he asked me to assure you of his respect for the importance of the section 232 process. He will have responsibility for concluding the 232 bearings investigation. Section 232 will not be a new responsibility for us. Under Secretary Freedenberg and I administered the 232 program until the October 1987 reorganization that created the Bureau of Export Administration.

During that period, we brought the machine tool 232 case to a successful resolution. We understand the delicate balance that must be maintained between maintaining U.S. industrial base and encouraging international free and fair trade. Section 232 gives us the authority to address this balance. We look forward to the challenge and responsibility of again effectively administering the statute in general and to bringing the bearing case to final resolution in particular.

I might add, parenthetically, that it was the Department of Commerce Office of Industrial Resource Administration, the office charged with doing this work, which originally suggested the bearing industry as one for consideration by the Joint Logistic Commanders. The Omnibus Trade Bill requires final action by the President on the 232 petition on or before November 21, 1988. Although this is less time than the President had anticipated for our further consideration of factors affecting the industry, an industry in transition at the present time, we will do the best possible job in the time left to us.

In this regard, I might add, that this hearing is especially helpful because it will provide us with important congressional insights on the matter. At this time, I would be happy to answer any questions you might have with our work.

[The prepared statement of Mr. Mercer follows:]

STATEMENT OF
LEE W. MERCER
DEPUTY UNDER SECRETARY OF COMMERCE
FOR EXPORT ADMINISTRATION
SEPTEMBER 8, 1988

It is a pleasure to be here today. Under Secretary Paul Freedenberg is on official travel today, but he has asked me to assure you of his respect for the importance of the Section 232 process. He will have responsibility for concluding the 232 bearings investigation. As many of you know, although the 232 bearings study was originally conducted under the umbrella of Commerce's International Trade Administration, the Omnibus Trade bill moved authority for Section 232 cases under our organization, the Bureau of Export Administration.

Section 232 will not be a new responsibility for us. In fact, Under Secretary Freedenberg and I administered the 232 program until the October 1987 reorganization that created the Bureau of Export Administration. During that period, we brought the machine tool 232 case to successful resolution. We understood the delicate balance that must be maintained between maintaining U.S. industrial base and encouraging international free trade. Section 232 gives us the authority to address this balance. We look forward to the challenge and responsibility of again effectively administering this statute in general, and to bringing the bearings case to final resolution in particular. The Omnibus Trade Bill requires final action by the President on or before November 21, 1988. Although this is less time than the President anticipated for our further consideration of factors affecting the industry at the present time, we will do the best possible job in the time left to us. In this regard, this hearing is especially helpful because it will provide us with important Congressional insights on this matter.

At this time, I would be pleased to answer any questions you might have.

Questions Submitted by Senator Lowell Weicker, Jr. for Lee W. Mercer

Question:

Mr. Mercer, what additional information will be used in preparation and resubmission of the 232 report back to the President for his consideration?

Answer:

We are preparing a supplemental report for the President at his request. He has asked us to evaluate the effect of DOD programs designed to improve the bearing industry's ability to meet national security requirements. We are working with the Defense Department to prepare the evaluation that the President requested and will forward policy recommendations to the President so that he will be able to reach a decision by the statutory deadline.

Question:

Does Commerce recognize the need to ensure that domestic bearing manufacturers have sufficient commercial sales in order to provide investment and capital necessary to serve our defense industry and our national security?

Answer:

The Department recognizes that the full range of regular precision and superprecision bearings are needed for national security purposes. Bearings are needed in all metal products with moving parts, and therefore are necessary for manufacturing defense products as mundane as motor vehicles and as sophisticated as high accuracy gyroscopes for missile guidance systems.

Question:

You are aware of the Customs investigation of the Minebea Corporation, which has approximately 80% of minature and instrument sized bearings. You are also aware that Mr. Bergan's office has copies of materials from this investigation. Will Commerce consider this investigation and related document in the preparation of the 232 report?

Answer:

Yes. The Department is reviewing the relevant material for the Section 232 investigation.

Question:

When does Commerce anticipate sending the report and recommendations back to the President?

Answer:

At this juncture, we cannot commit to a precise date. However, the Committee may be assured that the Department, in consultation with DOD, will respond to the President's request in a manner that will afford him ample opportunity to reach a final decision by the November 21 statutory deadline.

Question:

Has Commerce met with the Defense Department yet to update the report? Do you plan to meet further in preparation of the report?

Answer:

Commerce and Defense analysts have met to review this matter and we anticipate continuing close coordination with DOD during the entire process.

Question:

What is the Commerce Department's position on the exemption for the F.A.G. Corporation in the new Defense Department FAR?

Answer:

The Commerce Department opposes the exemption and has so advised the Defense Department in a letter from former Under Secretary Bruce Smart to DOD Deputy Secretary Taft, November 11, 1987. The Department reiterated this opposition in its formal comments on the draft FAR from former Acting Assistant Secretary Gilbert Kaplan to Charles W. Lloyd on April 27, 1988. (Copies enclosed)

Question:

How does this issue compare with the earlier effort, by your office, to assist the domestic machine tool industry?

Answer:

We are implementing a Domestic Action Plan to help revitalize both the machine tool and bearing industries. These two Action Plans are similar in many respects and we are optimistic regarding the benefits that they offer to both industries. However, it is also important to note that, based on our Section 232 machine tool investigation, the President decided to seek voluntary restraint agreements. We are currently administering these agreements with Japan and Taiwan. On the other hand, the President has not yet reached a final decision in the bearing Section 232 case.

Questions Submitted by Senator D'Amato for Department of Commerce Witnesses

Question:

Do you believe that U.S. international security interests are well served when an alleged ally like Japan coordinates through a government ministry -- in this case, the Ministry of International Trade and Industry -- commercial efforts to dominate an industry that is clearly vital to our national security?

Answer:

Coordinated action by any foreign government (ally, friend or adversary) to subvert market mechanisms and force U.S. competitors out of business is illegal under international law. Clearly, there would also be serious national security concerns should such unfair trade practices be targeted against a defense critical industry. There are effective remedies available under U.S. law in such situations, depending upon the nature of the activity concerned.

Question:

What should the U.S. response be to such actions by an ally? Does such government coordination raise the issue beyond one of mere "dumping" or alleged Customs fraud?

Answer:

It should first be noted that our allies depend upon the U.S. defense umbrella for their security. Thus, actions which undermine American defense manufacturing industries also can serve to undermine the collective security of the Free World.

If ever it were demonstrated that an allied government was actively seeking to undermine a critical U.S. defense industry through unfair or other orchestrated measures, the Department would immediately work with the Office of the U.S. Trade Representative, the Departments of State and Defense, and other relevant agencies to develop an appropriate course of action. Such action would, of course, be in addition to any remedial steps we and the affected industry might take under U.S. unfair trade and national security statutes.

Question:

I was pleased to learn that last Friday your agency, for the first time, decided to at least examine the documents that the Customs Service obtained in its investigation of Nippon Miniature Bearings, Inc. How soon can we expect to learn what your decision may be as to their relevance to either the Section 232 or Section 301 proceedings, and whether they will be used?

Answer:

In the next several days, the Department will complete its analysis both of the relevance of these materials to the Section 232 investigation and, with regard to the antidumping investigation, whether they may lawfully be used and whether they are relevant.

Question:

To what degree has Commerce coordinated with the Department of Defense to identify industries and industry segments that are critical to our national defense?

Answer:

The Commerce Department actively cooperates with DOD in this area. The Office of Industrial Resource Administration (OIRA) conducts joint industrial capabilities studies with DOD that highlight production bottlenecks in critical defense industries, identify the causes for these bottlenecks, and recommend appropriate remedies. Recent joint DOD/DOC projects have included studies of the bearings, gas turbine engine, precision optics and investment casting industries. Projects currently under way include a gear study with the Navy Department and a comprehensive evaluation of foreign dependency for the production of seven Navy weapon systems.

Question:

The Section 232 process is reactive, not, to use the current term, "pro-active." Do you believe that there should be a cooperative, energetic effort to identify critical defense industrial base concerns and then review apparently "commercial" assaults on these industries by foreign companies? In short, shouldn't the Department of Commerce take an aggressive leadership position to protect and preserve our ability to arm and equip our military forces in time of war?

Answer:

The Department is already doing so. OIRA has an active and productive "Industrial Capabilities Program" to focus on the root causes of production problems within U.S. manufacturing industries. This program is designed to highlight the full range of issues which may account for the deterioration of a defense critical industry or any portion thereof. We have found that high levels of imports are often only one of the reasons for problems in the U.S. industrial base. For example, OIRA's Industrial Capabilities Program has taken a leadership role in identifying military offset agreements as a cause for concern in the erosion of our defense subcontractor base. Based on these concerns, we are working with DOD and other agencies to seek international agreements to limit the use of offsets in defense trade.

When we do find that imports may pose a threat to the competitiveness of a defense industry, the Department has been active in recommending remedies. We fought successfully for implementation of the machine tool revitalization program which includes voluntary export restraint agreements with Japan and Taiwan. We also fought successfully to strengthen the DOD Federal Acquisition Regulation for bearings, and we are continuing to urge DOD to implement a FAR for the precision optics industry as recommended in our recent joint study.

Senator D'Amato. Thank you very much, Mr. Secretary. Mr. McCormack, if I might, the regulation that you alluded to—there seems to be some question by a number of staffers, does this regulation apply only to the bearings or to the bearings in component parts as well?

Mr. McCormack. It applies to bearings in component parts.

Senator D'Amato. It is all encompassing?

Mr. McCormack. Yes, sir. We purchase approximately between $500 and $600 million a year of bearings, and the net effect of it will be to provide incremental business in the amount of $350 million, by our estimates.

Senator D'Amato. You anticipated my next question. You are saying that at the present time, out of let us say approximately $500-$600 million in DOD purchases per year, that foreign firms provide about $350 million? Would that be at this time? Because you said the net——

Mr. McCormack. Yes, I did say that. I will have to check that figure but I believe——

Senator D'Amato. I calculated it the other way around. Let me try it this way. How much are domestic purchases now out of the $500 to $600 million in total bearing purchases now made by the Defense Department?

Or, if you want, how much of the purchase is foreign at the present time?

Mr. McCormack. We have estimated that approximately 35 percent of our purchases have been foreign.

Senator D'Amato. All right.

Mr. McCormack. The number I gave you would be a little high in terms of percentages.

Senator D'Amato. Fine. I also note that you made reference to the fact that in peacetime there are not enough defense procurements to support a large enough domestic bearing industry to meet surge or mobilization needs in times of crisis. Is that correct?

Mr. McCormack. I am sorry. Say that again?

Senator D'Amato. In your statement, and I think you correctly pointed this out, you said that the Defense procurement needs in peacetime are not enough by themselves to support a large enough domestic bearing industry to meet surge and mobilization needs during a crisis.

Mr. McCormack. Our market share is approximately 20 percent of the overall industry, and approximately 50 percent of the superprecision industry. It is heavily weighted toward the super-precision.

Senator D'Amato. Therefore, as a consequence of your previously stated national goal, it becomes important that a portion of the domestic market be preserved in the bearing industry for domestic manufacturers so they can be able to meet that contingency also.

Mr. McCormack. Absolutely. We would not have——

Senator D'Amato. Mr. Mercer, did you hear that?

Mr. Mercer. I heard that.

Senator D'Amato. I did not say that. That is Mr. McCormack. That is the Defense Department saying that.

Mr. McCormack. We need the commercial business to support the defense needs. There is no doubt about that.

Senator D'Amato. Let me take this opportunity first of all, to thank you three gentlemen. There are many, many questions and answers that we could discuss. I appreciate the difficult nature of the matters that are under your charge and under your review.

I understand that you recognize the complexities. I do not pretend to understand all the complexities, but I do feel very strongly that what we have seen is just another example of serious trouble in a particularly critical industry to this nation. The ball bearing industry is critical to our competitiveness and to our national security. That industry's problems, in my opinion, have been brought about by actions and activities that under every standard, are unfair and certainly violate the spirit, if not the letter, of the law.

I believe that, if we have the kind of investigation that I think is being conducted with thoroughness and with fairness, that those assumptions that I have made, which have been predicated on some review by staff and others, will be proven to be a fact. I for one am terribly disappointed. I am not disillusioned.

Let me conclude by saying it just seems to me that this is another example where the United States continues to place itself in a position of not being able to compete. Finally, in an extraordinary situation when the Government does step in, it may be too little and too late. I can just see the people, the crying, the shortages, and the manufacturers claiming that they cannot get the ball bearings. The costs are going to be too high, and there will be a little bit of that kind of manipulation that will be put into play.

I think the decision by the Defense Department to phase-in the contracts as they come due would hopefully offer those remaining domestic producers the opportunity to make available their ball bearings, so that they can rachet production up in a way that will not bring about tremendous price increases, and hopefully, will give them some help in meeting the foreign competition that they face. And they are not going to meet it unless we meet our obligations.

It seems to me that maybe we are afraid to rock the boat because there are very powerful interests on the other side. I have seen this take place in other manufacturing areas as well. And so we have all but surrendered, as Mr. Sperrazza has suggested, in many of these areas.

Gentlemen. Thank you. We are going to hold the record open for any additional comments. We are going to submit to you questions for the record, and we would appreciate your timely reply. Again, for those of you who have got these outstanding matters pending, the 232 petition, we wish you the best and hope that you make those decisions that should be made even if they may prove some difficulty. You may have OMB and other free traders screaming and yelling, but I do not think they really see the full picture of what is taking place.

We thank you. This Committee stands adjourned.

[Whereupon, at 12 noon, the hearing was adjourned.]

APPENDIX

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

September 6, 1988

TO : Senate Committee on Small Business
Attention: Tim Osborn

FROM : American Law Division

SUBJECT : Scope of the Department of Commerce's Authority to Accept and Use Third-Party Information in Antidumping Proceedings

This memorandum responds to your request for an analysis of the scope of the Department of Commerce's authority to accept and use information in antidumping proceedings that is made available by other government agencies. You have asked whether the Department has statutory authority to do this and, if so, whether there are any constraints or limitations on its power, such as statutory provisions governing the confidentiality of information so received. For reasons discussed below, it would seem that existing statutory authority does not preclude the Department from accepting and using such information, although Department practice and other considerations may make it reluctant to do so in particular situations.

The current antidumping statute, which is found in Title VII of the Tariff Act of 1930, 19 U.S.C. §§ 1673 et seq., was enacted in the Trade Agreements Act of 1979, Pub L. No. 96-39, Title I, which also repealed its predecessor, the Antidumping Act, 1921. Section 731 of the Tariff Act of 1930 (TA), 19 U.S.C. § 1673, provides that imports will be subject to antidumping duties where the Department of Commerce (DOC) determines that they are being, or are likely to be, sold in the United States at less than their fair value (LTFV) and the International Trade Commission (ITC) determines that a United States industry is materially injured, or threatened with material injury, or its establishment is being materially retarded, by reason of those imports. Once the DOC decides to proceed with an antidumping petition, it must initiate an LTFV investigation, TA § 732(c), 19 U.S.C. § 1673a(c), and so notify the ITC, TA § 732(d), 19 U.S.C. § 1673a(d)(1). The DOC and ITC must each make preliminary and final determinations with respect to the matters within their jurisdiction within statutory time periods; extensions are authorized for "extraordinarily complicated" cases and retroactive suspension of liquidation is to be imposed where "critical circumstances," that is, import surges, are found to exist. See generally, TA §§ 733, 735; 19 U.S.C. §§ 1673b, 1673d.

There are several provisions within the Tariff Act that specifically deal with information and its treatment in antidumping proceedings. For example, § 732(d)(2), 19 U.S.C. § 1673a(d)(2) provides that once the DOC determines that a petition alleges the elements necessary for the imposition of antidumping duties and contains information reasonably available to the petitioner supporting the allegations, the Department must, along with commencing an investigation, make available to the ITC "such information as it may have relating to the matter under investigation, under such procedures as the administering authority and the Commission may establish to prevent disclosure, other than with the consent of the party providing it or under protective order, of any information to which confidential treatment has been given by the ... [DOC]." In addition, the Act requires the DOC to base its preliminary determination, that is, "whether there is a reasonable basis to believe or suspect that ... merchandise is being sold, or likely to be sold at less than fair value," on the "best information available to it at the time of the determination." TA § 733(b)(1), 19 U.S.C. § 1673b(b)(1). The "best information available" standard is also applicable to the DOC's "critical circumstance" determinations, which must include findings of whether there is a reasonable basis to believe or suspect that there is a history of dumping of the subject merchandise in the United States, the importer knew or should have known that the exporter was making LTFV sales, and there have been massive imports of the subject merchandise over a relatively short period. TA § 733(e), 19 U.S.C. § 1673b(e). Provisions similar to § 732(d)(2), supra, regarding information that must be made available to the ITC and how such information should be protected, exist with respect to information used by the DOC in making its preliminary and final determinations. TA §§ 733(d)(3), 735(c)(1)(a); 19 U.S.C. §§ 1673b(d)(3), 1673d(c)(1)(A). Section 776 of the Tariff Act, 19 U.S.C. § 1677e, provides that except for information whose verification is waived under § 733(b)(2), 19 U.S.C. § 1673b(b)(2),[1] the DOC must verify all information it relies upon in making a final determination (as well certain determination regarding administrative reviews of existing antidumping and countervailing duty orders) and use the best information available as the basis for its determination where it is unable to verify the accuracy of the information submitted, including information submitted in support of the petition; in addition, in making any determinations, both the

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[1] Under this provision, the DOC must, within 75 days of beginning an investigation, have a designated individual review the information received during the first 60 days of the investigation and, if there appears to be sufficient information upon which a preliminary determination may reasonably be based, disclose to the petitioner any interested party who is then a party to the proceedings and requests such disclosure, all available nonconfidential information and all other information disclosed under § 777 of the Tariff Act, 19 U.S.C. § 1677f, relating to access to information. The petitioner and each interested party (as defined in Tariff Act, § 771(9)(C)-(E), 19 U.S.C. § 1677(9)(C)-(E)) to whom disclosure is made may furnish to the DOC an irrevocable written waiver of verification of the information that the DOC received, and an agreement that it is willing to have preliminary determination made on the basis of the record then available to the Department.

DOC and the ITC must use "the best information otherwise available" in any case where "a party or any other person refuses or is unable to produce information requested in a timely manner and in the form required, or otherwise significantly impedes an investigation."[2]

Section 777 of the Tariff Act, 19 U.S.C. § 1677f, sets forth detailed provisions regarding access to information used in antidumping proceedings. In enacting the provision, Congress was aware that antidumping and countervailing duty petitioners had "long contended that their ability to obtain relief ... [had] been impaired by ... [their] lack of access to the information presented by the exporters and foreign manufacturers," and, at the same time, that "importers, exporters, and other respondents in such cases ... [had] complained of lack of access to information supplied by the domestic parties to such cases, particularly with respect to the economic health of the domestic industry involved." S. Rep. No. 249, 96th Cong., 1st Sess. 100 (1979) [hereinafter cited as 1979 Senate Report]. The provision was thus intended to bring a certain amount of transparency to these proceedings by providing "the maximum availability of information to interested parties consistent with the need to provide adequate protection for information accorded confidential treatment." Id. See generally, Pattison, Antidumping and Countervailing Duty

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[2] There would seem to be at least two types of "best information available" standards at work: one serving as a less stringent standard for decision-making where information is otherwise unavailable (and thus acting as a means of inducing recalcitrant parties to provide information to the DOC), the other constituting a mandate for thorough investigations. See Budd Co. Ry. Div. v. United States, 507 F. Supp. 997 (Ct. Int'l Trade 1980), discussed infra. The latter standard, which is applicable to preliminary determinations, TA § 732, 19 U.S.C. § 1673a, would seem to affect the quality of final determinations as any information acquired at the preliminary stage would presumably be available throughout the proceeding. It would seem difficult to argue that only the first "best available information" standard, and not the second, is applicable at the final stage, given the legal impact of this determination and the presumably remedial nature of the antidumping statute.

Laws § 7.01 (1988).

The section allows the DOC to disclose "any proprietary information received in the course of a proceeding if it is disclosed in a form which cannot be associated with, or otherwise be used to identify, operations of a particular person," and "any information submitted in connection with a proceeding which is not designated as proprietary by the person submitting it." TA § 777(a)(4), 19 U.S.C. § 1677f(a)(4).[3] Except for proprietary information not associable with particular persons, information submitted to the DOC that is designated as proprietary by the person submitting it may not be disclosed, without that person's consent, to any person other than an officer or employee of the DOC or ITC who is directly concerned with carrying out the investigation in connection with which the information is submitted, or an officer or employee of the United States Customs Service who is directly involved in conducting an investigation regarding fraud involving dumped or subsidized imports. TA § 777(b)(1), 19 U.S.C. § 1677f(b)(1). The information for which proprietary treatment is requested must be accompanied by either a non-proprietary summary or a statement explaining why it is not susceptible to the same, and by either a statement permitting the DOC to release under administrative protective order (APO) the information submitted in confidence, or a statement that the information should not be released under APO. Id. The DOC may determine, based on the nature and extent of the information or its availability from public sources, that designation of the information as proprietary is unwarranted, and if it is not further persuaded to the contrary by the party submitting it, must return it to that party. TA § 777(b)(2), 19 U.S.C. § 1677f(b)(2). Upon receiving an application, the DOC may make proprietary information submitted by any other party to the proceeding available under a protective order that contains requirements that the DOC, by regulation, deems appropriate and whose violation is subject to sanctions. TA § 777(c)(1), 19 U.S.C. § 1677f(c)(1).[4] If the DOC denies a request for

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[3] Under its regulations, the DOC maintains an official record of all proceedings, which includes materials protected from disclosure, non-confidential material submitted by any person other than an employee or officer of the United States Government, and non-confidential and non-privileged material submitted or developed by an employee or officer of the United States Government. 19 C.F.R. § 353.25(a). DOC regulations regarding access to information in antidumping proceedings are set forth at 19 C.F.R. §§ 353.25 through 353.31.

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[4] Congress intended that the DOC's authority to make limited disclosure of proprietary information be a "specifically authorized exception" to the Trade Secrets Act, 18 U.S.C. § 1905, which penalizes the disclosure by United States officers and employees of confidential information that comes to them in the course of their employment "in any manner and to any extent not authorized by law." S. Rep. No. 249, 96th Cong., 1st Sess. 100 (1979); H.R. Rep. No. 317, 96th Cong., 1st Sess. 78 (1979). The application of § 1905 to interagency transfers is discussed infra.

It was also Congress' intent that the limited disclosure allowed under § 777 not result in any requirement for general disclosure under the Freedom of Information Act (FOIA). S. Rep. No. 249 at 100-101; H.R. Rep. No. 317 at 78. FOIA does provide, however, that its requirements are inapplicable to matters that are, inter alia, "specifically exempted from disclosure by statute ... provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld," 5 U.S.C. § 552(b)(3), and "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. § 552(b)(4). The United States Court of Appeals for the District or Columbia Circuit recently held that § 777 qualifies as a withholding statute that triggers the FOIA exemption set forth at 5 U.S.C. § 552(b)(3), discussed above. Mudge Rose Guthrie Alexander & Ferdon v. United States Int'l Trade Comm'n, 846 F.2d 1527 (D.C.Cir. 1988).

The same court has also ruled on the relationship of the Trade Secrets Act to these two exemptions. On one hand, it has held that the Trade Secrets Act, because of its "encyclopedic character and absent any limitation as to the agencies covered or the sources of data involved," may not be treated as a general withholding statute under § 552(b)(3). CNA Financial Corp. v. Donovan, 830 F.2d 1132 (D.C.Cir. 1987), cert. denied, 108 S.Ct. 481 (1988); see also 830 F.2d at 1141, n.62 for a list of cases concluding the same. A contrary conclusion was reached in Westinghouse Electric Corp. v. Schlesinger, 542 F.2d 1190 (4th Cir. 1976), cert. denied, 431 U.S. 924 (1977), although the Fourth Circuit may have since, at least impliedly, changed its view. See 830 F.2d at 1141, n. 62, citing General Motors Corp. v. Marshall, 654 F.2d 294, 297 & n.9 (4th Cir. 1981). The CNA court reconciled FOIA and the prohibition on proprietary information, the requesting party may then apply to the United States Court of International Trade for an order directing the DOC to make the information available. TA § 777(c)(2), 19 U.S.C. § 1677f(c)(2); American Spring Wire Corp. et al. v. United States, 4 C.I.T. 210 (1982). The Court may issue an order directing the DOC to make the information available under a protective order if the former finds that, under the standards applicable in proceedings of the court, such an order is warranted, and that the DOC has denied access to the information where requested by application under 19 U.S.C. § 1677f(c)(1), the person on whose behalf the information is requested is an interested party who is a party to the investigation in connection with which the information was obtained or developed, and the party who submitted the information to which the request relates has been notified, in advance of the hearing, of the request made under the section, and of its right to appear and be heard. TA § 777(c)(2), 19 U.S.C. § 1677f(c)(2). Information provided to the DOC by foreign governments is exempt from disclosure under APO. 19 C.F.R. §§ 353.30, 355.21 (1988); Exec. Order No. 12356, 47 Fed. Reg. 14874 (1982).[5] See generally, Taylor & Vermulst, "Disclosure of Confidential Information in Antidumping and Countervailing Duty Proceedings Under United States Law: A Framework for the European Communities," 21 Int'l Law. 43 (1987)[hereinafter cited as Taylor & Vermulst]; Stred, "International Trade: Court of

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disclosure that the Trade Secrets Act would still seem to require regardless of its status under the former by characterizing the Trade Secrets Act as "one of those prior-existing nondisclosure edicts that have been at least partially superseded by FOIA's newer public access mandate ... " 830 F.2d at 1141. At the same time, however, the court ruled that the Trade Secrets Act is "at least co-extensive with that of Exemption 4 of FOIA." 830 F.2d at 1151; see also cases cited at 1151, n. 138.

[5] Such information is present more often in countervailing duty proceedings, where allegations of foreign government subsidies are involved.

International Trade Disclosure of Confidential Information," 24 Harv. Int'l L. Rev. 219 (1983).

There appear to be no provisions in the Tariff Act provisions governing antidumping proceedings that speak expressly to the DOC's authority to obtain and use information from agencies that are not charged with specific functions under the antidumping statute. It may be argued, however, that § 733 of the Tariff Act, 19 U.S.C. § 1673b, which requires that preliminary determinations be made on the best information available to the DOC at the time of its determination, serves as an agency mandate to obtain information that pertains to an investigation at hand from any source. In at least one instance, the Court of International Trade viewed a similar provision applicable to the ITC as placing a duty on the investigating agency to conduct a vigorous investigation at the preliminary stage. In Budd Co. Ry. Div. v. United States, 507 F. Supp. 997 (Ct. Int'l Trade 1980), a case involving a challenge of ITC negative preliminary injury determinations in an antidumping investigation, the Court cited TA § 733(a), 19 U.S.C. § 1673b(a), regarding the use of "best information available" in preliminary injury determinations, and TA § 776(b), 19 U.S.C. § 1677e(b), regarding the use of "best information otherwise available" when parties do not submit requested information at the final determination stage, as evidence of Congress' expectation that the Commission "take an active role in obtaining information prior to its determination" and as "clearly express[ing] the congressional intent that the Commission will obtain information through its own investigative sources." 507 F. Supp. at 1000-1001. The Court rejected the government's argument, based on language in the Senate report accompanying the Trade Agreements Act of 1979, that the "reasonable indication" of injury language in § 733 placed on the petitioner the burden of proof of all facts necessary to establish a reasonable indication of a material injury or threat thereof, and took a broad view of where information might be obtained:

> Whatever significance the foregoing [report] statement should receive, it is manifest that the term "burden of proof" used in an investigative proceeding does not have the same meaning as when used in an adjudicatory proceeding. Clearly, in the latter instance the bearer of this burden would have a more extensive means of obtaining information to satisfy that burden.
>
> It is the opinion of this court that the oblique reference to "burden of proof" contained solely in the Senate Committee Report can neither qualify or immunize the duties or obligation imparted by the explicit language of the statute and the legislative history charging the Commission to make its preliminary determination on the "best information available." It must be emphasized that this mandate does not limit "the best information available" to that furnished by the petitioner or by any party-in-interest to the proceedings. The term "available" as used in the statute must be construed in accordance with its common meaning. In so doing, it is clear that all information that is "accessible or may be obtained," from whatever its source must be reasonably sought by the Commission. It is only in this manner that the Commission comply with the intended congressional mandate to conduct a "thorough investigation." 507 F. Supp. at 1003-1004 (emphasis added).

The Trade Agreements Act (TAA) had placed the ITC in a new position with respect to antidumping proceedings in that United States law now contained provisions for DOC petition and ITC preliminary injury determinations that presumably made the antidumping statute consistent the GATT Antidumping Code, which requires consideration of both injury and LTFV sales before an antidumping investigation is initiated. See 1979 Senate Report at 66. Under the statute, the ITC has 45 days within which to make its determination and, unlike prior law, must make such a determination in every case; both the Senate and House reports on the TAA note that the 45-day period is a brief one but still contemplate that the ITC will undertake a "thorough" investigation. 1979 Senate Report at 66; H.R. Rep. No. 317, 96th Cong., 1st Sess. 61 (1979) [hereinafter cited as 1979 House Report]. As stated in the House report:

> The time limit provided in the bill for an ITC preliminary determination, although longer than that under present law, is still quite brief. It is therefore intended that the ITC will investigate the allegations in the petition in as thorough a manner as possible using the information available within that time period, and will provide interested parties a reasonable opportunity to present their views. Such opportunity does not necessarily include a hearing such as that required prior to a final determination. Id.

The Budd court cited this language, 507 F. Supp. at 1000-1001, along with a Senate report statement that the nature of the ITC's inquiry "may vary from case to case depending on the nature of the information available and the complexity of the issues." 1979 Senate Report at 66, quoted in 507 F. Supp. at 1000-1001.

While Budd Co. involved a congressional mandate specifically directed at the ITC, and the court, in interpreting the statute, took note of, not only this mandate, but also the fact that the ITC has its own statutory subpoena power to seek both confidential and non-confidential information, 507 F. Supp. at 1001-1002, one may nonetheless argue that the breadth of the "best information available" language construed in Budd Co. is not limited to ITC preliminary determinations, but applies as well to the DOC. The statutory mandate is identical with respect to both agencies. TA §§ 733(a),(b)(1), 776(b); 19 U.S.C. §§ 1673b(a,(b)(1), 1677e(b). Although there does not appear to be any similar report language directed at the DOC, it is possible that Congress did not need to describe the Department's role in the same way it described that of the ITC inasmuch as the Department had already been charged with making preliminary LTFV determinations with a then 6-month deadline. Antidumping Act, 1921, § 201(b)(1). Further, the fact that a "thorough" investigation is expected of an agency that has 45 days in which to make a preliminary determination would seem to indicate that the same might well be contemplated for an agency that has 160 days to do so. See TA § 733(b)(1), 19 U.S.C. § 1673b(1). In addition, the availability of subpoena power would not seem to be relevant in determining the scope of an agency's authority to acquire information from another government agency where that information is made available voluntarily and is not otherwise legally encumbered. It may also be noted that the court used both "best information available" standards to support its conclusion that the Commission was charged with conducting a thorough investigation at the preliminary stage and arguably implied that such a standard exists at all stages of an antidumping proceeding.

Even though Congress seemingly intended that agencies accept information in antidumping proceedings from a broad range of sources, it is possible that the Department may nevertheless be reluctant to do so where that information may be proprietary in nature. Where a party to the proceeding provides information to the Department and requests that it be deemed proprietary, the statute sets forth specific procedures for the disposition of that request, allows for limited disclosure where information is granted proprietary treatment, and provides for the possibility of court-ordered disclosure where the Department has refused a disclosure request. TA § 777, 19 U.S.C. § 1677f. In providing that information is generally not to be disclosed where it is designated as proprietary "by the person submitting it," and given the nature of the information at issue (e.g., information regarding profits, production costs, volume of sales, prices, customer names, return on investment), the statute would seem to be directed at business firms. At the same time, an agency possessing information useful to another agency might consider it to be proprietary at the outset for purposes of the Trade Secrets Act, 18 U.S.C. § 1905. That statute provides as follows:

> Whoever, being an officer or employee of the United States or of any department or agency thereof, publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information coming to him in the course of his employment or official duties or by reason of any examination or investigation made by, or return, report or record made to or filed with, such department or agency or officer of employee thereof, which information concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association; or permits any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; shall be fined not more than $1,000, or imprisoned not more than one year, or both; and shall be removed from office or employment.

Some case law suggests, however, that the Trade Secrets Act may be inapplicable to interagency transfers of information. While the Act has in at least one instance been assumed to apply in this situation, Shell Oil Co. v. Dep't of Energy, 477 F. Supp. 413, 432 (D. Del. 1979), a federal appeals court has concluded that the Trade Secrets Act was intended to apply only to public disclosures of trade secret material and not to prohibit transfers between agencies. Emerson Electric Co. v. Schlesinger, 609 F.2d 898, 907 (8th Cir. 1979); see also Interco, Inc. v. Federal Trade Comm'n, 490 F. Supp. 39 (D.D.C. 1979)(holding that release of information containing trade secrets by the FTC to state attorneys general was not a public disclosure and was thus "authorized by law" for purposes of the Trade Secrets Act); Ashland Oil v. Federal Trade Comm'n, 548 F.2d 977 (D.C. Cir. 1976)(upholding the authority of the FTC to transmit confidential information to Congress under § 6(f) of the Federal Trade Commission Act, 15 U.S.C. § 46(f)); and infra, n.7. The Supreme Court has also made it clear that the Act does not preclude transfers where they are authorized either by statute or by properly issued agency regulations having a reasonable relationship to the purpose and scope of a statutory grant substantive rulemaking authority. Chrysler Corp. v. Brown, 441 U.S. 281, 301-316 (1979).[6] Recently, the United States Court of Appeals for the District of Columbia Circuit, in examining whether the scope of the Trade Secrets Act was coterminus with that of the three statutes on which it was based, appeared to indicate that the legal authorization requirement applied only to public disclosures, noting that its examination "is of much more than academic interest to federal agencies that currently do not have public access regulations qualifying as legal authorizations for disclosures otherwise prohibited by the Trade Secrets Act." CNA Financial Corp. v. Donovan, 830 F.2d at 1144 (emphasis added).

Were the Commerce Department to receive information from another agency, and assuming there were no other legal strictures on the use of the information, that information would seem to be subject to the requirements of § 777. As noted earlier, Congress intended that this provision be a specifically authorized exemption to the Trade Secrets Act. See supra, n.4. It is unclear, however, how the DOC would treat a request for disclosure of proprietary material received in this way, and research reveals no case regarding standards for disclosing information, theoretically proprietary in nature, that is provided by a federal agency rather than a party or business non-party to a proceeding.[7] The statute provides for proprietary designations by persons submitting the information, TA § 777(a)(1), 19 U.S.C. § 1677f(a)(1), and speaks to disclosure requests for information submitted by any other party to the investigation. TA § 777(c)(1)(A), 19 U.S.C. § 1677f(c)(1)(A). The same considerations that prompt a firm to request material to be treated confidentially may not be present with respect to an agency in possession of that information, especially where Trade Secrets Act questions are obviated.

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[6] Proprietary information in the possession of the DOC and ITC may be made available to officers and employees of the United States Customs Service who are directly involved in conducting investigations regarding fraud involving subsidized or dumped imports. TA § 777(b)(1), 19 U.S.C. § 1677f(b)(1). In enacting this provision, Congress intended to allow the release of such information "solely to prevent an unintended restriction from continuing. The reason for this change is to improve administration of the customs laws by increasing the likelihood that parties allegedly engaging in civil fraud will be scrutinized." H.R. Rep. No. 725, 98th Cong., 2d Sess. 44 (1984). It is unclear from the House Report whether Congress viewed the Trade Secrets Act as causing the current restriction. It might be noted, however, that to the extent that the Customs Service makes information available to other agencies under law or regulation, or does so based on the premise that the Trade Secrets Act applies only to public disclosures, the fact that Congress allowed for transfers from the DOC and ITC to the Customs Service does not seem necessarily to have implications with respect to the Service's existing authority to transfer information to other agencies.

Commerce Department regulations provide that the Department will consider information to be privileged or confidential only if its disclosure would be likely to (1) cause substantial harm to the competitive position of the person submitting it; (2) have a substantial adverse effect upon the person supplying the information or upon the person from whom the information was obtained; or (3) impair the ability of the United States Government to obtain in the future necessary information, not required by law to be provided, from the same persons or others similarly situated. 19 C.F.R. § 353.29. Among the many court decisions on information disclosure under § 777, Sacilor, Acieries et Laminoirs de Lorraine v. United States, 3 I.T.R.D. 2225 (Ct. Int'l Trade 1985), explained that "the release of confidential information must be the result of a reasoned decision which carefully evaluates the need of the applicant as opposed to the demands of confidentiality. This decision should not confuse the role and need of a party to an administrative investigation with that of a litigant in a court of law and it should not reflect an abdication of the investigative duties of the agency." *Id.* at 2227. In *Arbed, S.A. v. United States*, 3 I.T.R.D. 2369 (Ct. Int'l Trade 1982), the court found within the investigating agency "a range of discretion ... to determine the degree of exposure to confidential information consistent with the objectives of the investigation and the dictates of the law." *Id.* at 2372. Commentators have recently observed that the DOC's "lenient administrative attitude toward disclosure, together with the ... [Court of International Trade's] grant of administrative discretion in this field, suggests that in most cases counsel for petitioners will get access to confidential data submitted by foreign producers." *Taylor & Vermulst* at 51.

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[7] It is important to note that federal law requires that any agency receiving information from another agency is subject to the same legal strictures as the latter, including those provisions of law relating to the unlawful disclosure of information. 44 U.S.C. § 3510(b). This provision would seem also to imply that interagency transfer of confidential information is contemplated. See also Int'l Trade Comm'n General Cousel Memorandum GC-83-107 for a discussion of the Commerce Department's obligation to maintain the confidentiality of any such information provided to it by the ITC under § 337(b)(3) of the Tariff Act, 19 U.S.C. § 1337(b)(3), which requires the Commission to notify the Department whenever, in the course of a § 337 investigation "the Commission has reason to believe, based on information before it, that a matter, in whole or in part, may come within the purview of" the antidumping or countervailing duty laws.

We hope that this discussion will be helpful to you and that you will call on us if you have any additional questions.

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September 22, 1988

Honorable Lowell Weicker
Chairman
Senate Committee on Small Business
Russell Senate Office Building
Room 428A
Washington, D.C. 20510

Attention: Ms. Tracy Crowley

Dear Mr. Chairman:

Re: Comments of The Timken Company Concerning the Impact of Foreign Competition on the Domestic Bearing Industry

The Timken Company, of Canton, Ohio, is pleased to present its comments on the impact of foreign competition upon the domestic bearings industry. As the nation's largest producer of tapered roller bearings, The Timken Company is gratified to discuss recent positive developments as they affect the bearing industry. Publication of antidumping duty orders on tapered roller bearings from six countries, revision of the Defense Department's Acquisition Regulations to require purchase of certain types of bearings from domestic sources, and the recommendation of the Secretary of Commerce to the President under Section 232 of the Tariff Act, are promising.

It is too early, however, to conclude that these measures will be sufficient. Although there has been progress in redressing the unfair trade pratices of foreign tapered roller bearing manufacturers and otherwise supporting the manufacturers of antifriction bearings in the United States, the remedies provided require time to have effect.

Reinvestment and rebuilding of the productive capacity lost to unfairly traded imports over many years will not happen overnight. Sustained protection against unfairly traded imports and a "level playing field" over the long term will permit the industry to recover from the effects of unfair trade. Publication of the order is only the starting signal for the process to commence.

Morever, as the orders redressing unfair trade provide a foundation for recovery from the effects of prolonged dumping, so too, the section 232 recommendation and revised Defense regulations procurement may in time provide relief in that segment of industry that serves the defense needs of our nation. Section 232 is intended to correct and repair injury to the industrial mobilization base of our nation. The revised regulations published to administer the bearing action plan exclude commercial bearings. Thus, the section 232 remedy and the revisions to the regulations do not address the same problem as the dumping orders; nor will rebuilding for defense needs be accomplished by dumping orders with the intended and hoped for effect of eliminating dumping of commercial bearings in the U.S. market.

In the pages which follow, Timken briefly reviews the history of these proceedings and its experience in the market place as established before the Department of Commerce, the International Trade Commission, and the Defense Department. Where, as here, there is both a finding of material injury by reason of dumped imports and a finding of impairment of the national security through the loss of our mobilization base, it is clear that action is needed. Timken appreciates both the attention of the Committee and the Congress to the serious peril that confronts the bearing industry.

I. Dumping Finding on Tapered Roller Bearings

Faced with severely deteriorating financial performance in the mid-1970's due to imports of unfairly-priced bearings from Japan, The Timken Company first petitioned the Government to address the situation in 1972. The International Trade Commission and the Treasury Department (then empowered with administration of the antidumping and countervailing duty laws) determined that the domestic tapered roller bearing industry had suffered material injury due to imports of less-than-fair-value bearings from Japan, and an antidumping duty order issued in 1976. Tapered Roller Bearings and Components from Japan, 44 Fed. Reg. 34,974 (Dep't Treas. 1976). Despite the affirmative determinations, for a number of reasons the dumping finding did not translate into appreciable relief from dumped imports from Japan in the years after publication of the dumping finding.[1] Fully aware of Treasury's dismal record in enforcing similar finding in past cases, the major Japanese producers continued to sell their product at less than fair value.

Due in part to protracted litigation which arose from the 1982 revocation of the dumping finding with respect to the largest Japanese producer, the Department of Commerce has assessed virtually no antidumping duties on imports of the major Japanese manufacturers in the intervening twelve years since the original dumping finding. In 1981, Commerce interpreted the finding not to encompass parts of tapered roller bearings, thus opening the door for the establishment of U.S. subsidiaries which assemble finished components and thereby circumvent the dumping finding. See Tapered Roller Bearings and Certain Components Thereof from Japan, 46 Fed. Reg. 43,864 (September 1, 1981).

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[1] One reason for the amendments to the antidumping law in in 1979 and the transfer of authority from Treasury to Commerce was Congress' dissatisfaction with Treasury's prosecution of dumping cases. See S. Rep. No. 249, 96th Cong. 1st Sess. (1979).

In addition, as imports of automobiles and consumer goods from Japan increased during these years, the domestic producers witnessed a decline in domestic demand for tapered roller bearings. These factors, coupled with the extensive delay in assessment of antidumping duties dating back more than ten years, frustrated the meaningful relief which Congress intended for industries beset by unfair trade practices. Imports from Japan continued to grow after issuance of the dumping finding, as total imports in 1979 more than doubled from the 1974 level to $518.9 million. Imports in 1984 were over $700 million -- more than ten times the level of imports in 1967.

II. Competitive Environment in the Early 1980's

In the early 1980s, Timken witnessed its traditional market for large-volume, commodity type bearings being rapidly eroded by unfairly-traded imports, primarily from Japan but also from other countries. Although Timken and several other antifriction bearing producers manufacture a complete line of bearings, totalling many thousands of part numbers, the majority of their sales is concentrated in a relatively small number of bearings which are produced in large quantities, often on dedicted production lines. Foreign producers, eager to gain market penetration, targeted these part numbers, leading to the virtual exclusion of Timken and other domestic manufacturers from this lucrative portion of the tapered roller bearing market.

Moreover, the presence of effective antidumping measures on various types of antifriction bearings in the European Community caused the United States to become the dumping ground for multinational producers burdened with excess production capacity during the global economic downturn of the early 1980s.

Bearing manufacturers in Eastern Europe and the People's Republic of China made use of favorable labor and foreign exchange rates to capture the so-called low- and medium-duty use market, in which quality and after-sale service were not at a premium. The Japanese producers, aided by a government-sanctioned bearing cartel which was in force in the Japanese market from the end of World War II until 1985, often acted to deprive domestic manufacturers of business at large-volume accounts. During this period, the Japanese producers seldom bid against one another at any U.S. accounts, while at least one Japanese manufacturer was known to quote at twenty percent off of Timken's lowest price, symbolic of the extreme and irrational price competition which Timken experienced in these years.

From 1980 to 1985, Timken suffered severe financial reversals, due in large part to an increase in the volume of less-than-fair value imports of bearings. Timken recorded losses on its overall operation amounting to $200 million between 1980 and 1986. Timken's bearing-related employment declined from 19,313 to 16,565 between 1984 and 1986. The majority of these declines is directly attributable to the unfair trading practices of the major bearing producers.

Timken's experience was not unique but rather paralled that of the antifriction bearing industry as a whole, as numerous studies conducted by various agencies of the U.S. government have documented. In 1986, a series of reports were issued which detailed the findings of these investigations. In January, the International Trade Commission released its report, Competitive Assessment of the U.S. Ball and Roller Bearing Industry, Inv. No. 332-211, USITC Pub. 1797 (January 1986), which documented the decline of the U.S. bearings industry and the tapered roller bearing portion of that industry in particular. The Department of Commerce drew similar conclusions in its report, Competitive Assessment of the U.S. Ball and Roller Bearing Industry, U.S. Department of Commerce (February 1985).

The Department of Defense also documented the domestic industry's loss of market share to producers in other nations, particularly Japan. Joint Logistics Commanders Bearing Study (June 1986). The Joint Logistics Commanders Report concluded that without remedial measures, the domestic industry would likely be unable to produce the quantities of bearings required in wartime. Thus, both the high-volume, commercial segment of the industry and the productive facilities available to meet the nation's industrial mobilization base are imperiled.

III. Antidumping Duty Orders on Tapered Roller Bearings

In August of 1986, Timken filed antidumping duty petitions with the Department of Commerce and the International Trade Administration alleging that imports of tapered roller bearings and parts thereof from six countries were being sold at less than fair value. After investigation, the International Trade Commission determined that the domestic tapered roller bearing industry was suffering material harm by reasons of unfairly traded imports from the subject countries. See Tapered Roller Bearings and Parts Thereof from Japan, USITC Pub. 2020 (1987); Tapered Roller Bearings and Parts Thereof from Italy and Yugoslavia, USITC Pub. 1999 (1987); Tapered Roller Bearings and Parts Thereof from Hungary, the People's Republic of China, and Romania, USITC Pub. 1983 (1987). The Department of Commerce determined that imports from each of the countries were sold at less than fair value during the period of investigation. Japanese tapered roller bearings, which represented 30 percent of apparent domestic consumption during the period immediately preceeding the dumping investigations, were found to have been dumped by margins of more than 36% *ad valorem*.[2]

The antidumping duty orders, which are currently under judicial review in the Court of International Trade, promise substantial relief to

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[2] The Department of Commerce issued antidumping duty orders requiring the deposit of estimated duties at the following *ad valorem* rates: Japan, 36.21 percent (52 Fed. Reg. 47,955); Italy, 124.75 percent (52 Fed. Reg. 30,417); Yugoslavia, 33.61 percent (52 Fed. Reg. 30,417); People's Republic of China, 0.97 percent (52 Fed. Reg. 22,667); Hungary, 7.42 percent (52 Fed. Reg. 23,319).

Timken and other domestic tapered roller bearing producers. Manufacturers in the countries subject to the order, mindful that dumping duties will be levied on all transactions conducted at less than fair value, have in many cases implemented across-the-board price hikes. The volume of these price increases, however, belies the fact that only now, after years of price discrimination, are prices in the United States starting to approach levels which represent fair value. The Timken Company, unburdened of the effects of illegal price competition, has begun to recapture business at many accounts -- business which was lost solely because of unfair and illegal pricing strategies engaged in by foreign producers.

Nevertheless, the domestic tapered roller bearing industry still faces obstacles to continued recovery. The effect of years of decreased investment in capital equipment and research and development, during periods of losses, continues to be felt. Further, the continued effectiveness of the antidumping duty orders requires that the Commerce Department be agressive in enforecment and alert to possible avenues of circumvention. Foreign manufacturers, particularly the large multinational producers which possess factories in many countries, busily develop strategies to evade the reach of the orders. Large multinational producers may shift production to countries not subject to antidumping scrutiny, and may seek exclusion for various bearing parts (expressly included in Timken's antidumping petition) which are imported for further manufacture by their U.S. subsidiaries.

Invariably, too, there will be complaints from domestic users of bearings at the short-term effects of the dumping orders. The intention of the law is that the price depression and suppression caused by dumping will be eradicated. So, price increases already have been announced. And, the domestic producers, unable for so long to obtain fair prices, suffered continued diminishment of their capacity to produce bearings and ability to service the needs of the entire domestic market. Thus, there may be a period in which domestic manufacturers are unable immediately to respond to total demand.

It would be an error, however, to conclude that these effects are a failing of the antidumping duty order. Imports continue to have complete access to the U.S. market -- so long as they sell their products at fair value. Only over time as the effects of the orders protect the industry from dumping will the law be able to work as it was intended. Price increases manifest that the law is working as intended, that the domestic industry is returning to a profitable level of capacity utilization, employment, and investment, both with respect to commercial bearings and with respect to bearings needed for defense.

Finally, the antidumping duty law, by virtue of its complexity, is susceptible to administrative interpretations which permit the reduction or negation of antidumping duties which are properly payable. Congress has amended the law repeatedly, in 1979, 1984, and 1987 reducing the discretion of the administrators, speeding and simplifying the processes, and curtailing administrative interpretations that openned loopholes in the law. The ability of the domestic tapered roller bearing industry to obtain relief from the 1987 orders that it did not obtain from the 1976 orders depends upon even-handed but agressive enforcement of the antidumping duty orders in force.

IV. Department of Commerce Section 232 Report

On July 15 of this year, Commerce Secretary C. William Verity forwarded to the President his recommendation under Section 232 of the Trade Expansion Act concerning the status of the domestic bearing industry. Under the statute, the President has authority to impose limits on imports of bearings or to impose other measures necessary to assure that the domestic industry remains capable of meeting national security requirements in both war and peace. The Secretary's report addresses the ability of the industry to meet the nation's defense-related demands for antifriction bearings, as well as the national security implications of the decline in production capacity and increased dependence on foreign sources for bearings crucial to the defense effort.

The President has deferred final action on the Secretary's recommendation, pending the implementation of the final stages of the Department of Defense's Bearing Action Plan later this year. Through a statement issued by Secretary Verity, the President has stated his intent to pursue a course of action which would improve the domestic industry's ability to meet the country's requirements for bearings. Because the intent of Section 232 is to protect national security, the remedies ordered by the President should address the full range of harm which the domestic industry has suffered from all factors. As antidumping duty orders address price discrimination which is presently occurring in the marketplace, the remedies under consideration by the President should address the cumulative effect of unfair trade practices which have plagued the tapered roller bearing industry for many years. The remedies invoked should be structured to encourage growth in employment and increases in research and capital investment to assure that domestic sources are capable of meeting future national defense needs for tapered roller bearings.

V. Department of Defense Actions

As noted above, in 1986 the Department of Defense published a comprehensive report entitled Joint Logistics Commanders Bearing Study. The report concluded that the domestic bearing industry was at risk and would suffer a "dramatic contraction" if no action were taken. JLC Bearing Study at v. Recommended actions included "regulatory changes, legislative enactments, and clear administrative policy directions" designed to bolster the position of the domestic industry. Id. For its part, the Department of Defense initiated a comprehensive review of its own procurement of antifriction bearings, which in 1986 comprised approximately 17% of domestic consumption. As a result of this review, the Department amended the Federal Acquisition Regulations (FAR) to require that Defense Department acquisitions of antifriction earings be satisfied from domestic sources for a period of three years, until September 20, 1991. See 53 Fed. Reg. 29,332 (August 4, 1988). A similar requirement for ball bearings of less than 30mm outside diameter has been in effect since 1971. See 48 C.F.R. § 252.208-7000.

Timken welcomes the Defense Departments' adoption of the domestic production regulation as an important step toward strengthening the domestic production base for tapered roller bearings. It is important to note, however, that not all defense procurement is governed by the Defense procurement regulations, nor does the new regulation apply to certain "imbedded" bearings, i.e., bearings which are incorporated into a manufactured product which has other commercial uses. Continued monitoring of the procurement process is necessary to insure that the new regulations are effectively implemented.

VII. Conclusion

The Department of Commerce, the Department of Defense, and the International Trade Commission have each contributed to reversing the decline which had beset The Timken Company and other domestic bearing manufacturers. The determination that imports of tapered roller bearings from six countries were unfairly traded and had materially injured the domestic industry, and the issuance of antidumping duty orders on those imports, has started to restore fair price competition to the marketplace. Timken is confident that the President, pursuant to his authority under Section 232, will later this year implement a program to insure the continued vitality of the tapered roller bearing industry as a critical element of the nation's industrial mobilization base. Finally, the adoption of limited-period Defense Department purchasing regulations on antifriction bearings will permit the domestic industry to recapture the important defense-related bearing market. Freed of the illegal price discrimination which plagued the industry for many years, and assured of continued agressive enforcement of our nation's unfair trade laws, Timken is confident that it can prosper in the years to come. However, the support of the Congress and of the Committee and the continued participation of both in the administration of the antidumping laws and in the maintenance of the national defense are vital to ensure that the effect of these remedies is achieved.

Respectfully submitted,

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Special Counsel for
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September 22, 1988

Statement by H. William Tanaka, Counsel,
New Hampshire Ball Bearings, Inc., Peterborough, New Hampshire
before the Senate Small Business Committee
September 8, 1988

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Statement by H. William Tanaka, Counsel,
New Hampshire Ball Bearings, Inc., Peterborough, New Hampshire
before the Senate Small Business Committee
September 8, 1988

The United States is in the midst of a period of strong economic growth which has seen American industries -- including the bearing industry -- begin to reclaim their once-traditional position as efficient competitors in the global marketplace. This revival of American competitiveness has been driven in part by U.S. opposition to protectionism or restrictions on foreign investment. The latter has been particularly important because foreign investment has helped reinvigorate U.S. industries -- including the bearing industry -- and revive overall U.S. competitiveness.

The Importance of Foreign Investment to the U.S. Economy

Foreign investment in the U.S. has been fostered by such factors as the weak dollar, the desire of foreign manufacturers to establish production facilities near their American markets, and concern about growing protectionist sentiments in the U.S. Foreign investment has also been driven by the needs of the U.S. economy, however.

For example, foreign investors have helped finance the huge budget and trade deficits incurred during recent years. Foreign holdings of U.S. government securities increased by 60 percent from 1983 to 1987, and accounted for approximately 10 percent of the outstanding federal government debt by the end of 1987.

More importantly, foreign investors have played a vital role in rebuilding basic industries in the U.S. Foreign investors have introduced U.S. industries to new production and process technologies and to new techniques of quality assurance. Foreign investors have also provided training to a growing body of American workers who have been given good jobs and the technical skills to hold such jobs in the future. And foreign investors have provided the competition needed to spur American industries to improve their competitiveness in cost, quality and service.

Japanese investors have made particularly important contributions. For example, Japanese investors have played a critical role in financing U.S. government debt. Japan tripled its holdings of short-term U.S. Treasury securities between 1983 and 1987, and Japan consequently accounted for 21 percent of total foreign holdings of short-term U.S. Treasury debt as of June 30, 1988. Japan clearly has contributed to the supply of needed capital for both U.S. public and private investment.

The Japanese have also made important contributions to the U.S. industrial base by investing in plants and other facilities and in American companies. Japan's direct investments in the U.S. tripled in dollar terms over the past four years, and its share of total direct foreign investment in the U.S. increased by 50 percent during that period. These increases illustrate the commitment of Japanese companies to U.S. production. (See Table.)

Japanese Direct Investment in the U.S. Bearing Industry

Japanese direct investment has been particularly important to weak domestic industries. Direct investment in the U.S. by the Japanese bearing industry offers a classic illustration of how foreign investment can provide a declining U.S. industry with much-needed capital and technology.

Virtually every major Japanese bearing company has either constructed or acquired a facility in the U.S. during the last 20 years. In 1972, for example, Nippon Miniature Bearing Co., Ltd. (now known as Minebea) acquired the Reed Division of SKF Industries in Chatsworth, California to produce smaller precision radial ball bearings. Also in 1972, NTN Toyo Bearing Corporation built a new plant in Schiller Park, Illinois to produce larger high-volume ball bearings. NTN subsequently built another plant in Elgin, Illinois. In 1975, a joint venture between Nippon Seiko Co., Ltd. and Hoover Ball and Bearing Co. built a modern plant in Clarinda, Iowa to produce radial ball bearings. Later in the 1970s, Koyo Seiko Co., Ltd. constructed a highly-automated ball and tapered roller bearing plant in Orangeburg, South Carolina. These direct investments illustrate the Japanese bearing industry's long-standing commitment to domestic production for the American market.

The Minebea acquisition of SKF's Reed Division represents a particularly good example of beneficial foreign investment. Minebea's acquisition occurred at a time when domestic bearing companies were extensively disinvesting out of bearing production. SKF had sought to sell its Reed Division due to an abrupt shift in the technology for aircraft instruments during the early 1970s from electro-mechanical to digital readout systems, which virtually eliminated the market for aircraft instrumentation bearings. The Reed Division, whose production was concentrated in radial ball bearings of 30 mm and under -- the principal market for which was aircraft instrumentation -- was thus left without a market for its products. Minebea's acquisition kept the company in business.

Minebea's acquisition of New Hampshire Ball Bearings, Inc. (NHBB) in 1985 also represented a significant contribution by foreign investors to the overall health of the U.S. bearing industry. Minebea's payment of $210 million to the shareholders of NHBB provided new capital for reinvestment throughout the regional economy of the Northeast and New England. Minebea also invested $28 million in new state-of-the-art production equipment in NHBB plants containing aging equipment. This investment in the latest cost-efficient production equipment and technology -- with an additional $5 million of new equipment still on order -- has transformed NHBB into an efficient and internationally competitive producer which is providing a sizeable benefit to the economy of the region.

Investments by foreign-owned bearing companies have been important in the nation's industrial heartland as well. For instance, NTN Toyo Bearing Corporation's investments in the State of Illinois include three manufacturing plants -- including a recently expanded plant -- a subsidiary's corporate headquarters, an automotive test laboratory and a primary warehouse and distribution center. NTN Toyo's total U.S. employment exceeds 1500, and its annual sales volume is approximately $250 million.

These investments by Japanese bearing producers -- as well as investments by European bearing firms -- have helped create a more vibrant and competitive U.S. bearing industry. Japanese firms have brought cost-efficient production equipment and process technologies to their U.S. plants, and have provided jobs and training for a large skilled labor force. Japanese and European firms have also purchased and modernized out-dated American facilities which were destined to close, thus preserving jobs and domestic production capacity. These investments by foreign bearing companies have helped lower manufacturing costs, increase quality, reduce prices and increase the profitability and competitiveness of the American bearing industry.

The Revival of the U.S. Bearing Industry

The improving health of the U.S. bearing industry can be seen in the strong recent performance of such key American-owned firms as the Ingersoll-Rand Company, the Barden Corporation, the Timken Company, Rexnord, Inc., and the Hoover Group, Inc. For example, Ingersoll-Rand's bearings, locks and tools segment -- which includes the Torrington Co. and the Fafnir Bearing Co. -- reported increased sales in each of the last four years and increased operating profits in four of the last five years. Indeed, Ingersoll-Rand's bearings, locks and tools segment increased its sales by 44 percent and its operating income by 222 percent between 1982 and 1986.

The strong performances by Ingersoll-Rand and Timken also demonstrate the benefits reaped recently by those American bearing producers that have recognized and taken advantage of the industry's growing globalization.

Ingersoll-Rand's extensive operations in Britain, Canada, Japan and South Africa have contributed to the company's profitability in recent years. According to a recent Ingersoll-Rand annual report, the company's bearing operations now employ nearly 13,000 people in 29 plants worldwide.

Timken has also benefitted from profitable overseas operations, with plants in Britain, France, Australia, Brazil, Canada and South Africa. Timken and other American producers have also seen their export operations grow in profitability in recent years as the value of the dollar has dropped in comparison to other currencies. Thus forward-looking American bearing producers have been able to capitalize on the increasing internationalization of bearing procurement, production and marketing.

In fact, the U.S. bearing industry is presently thriving by all accounts. The most recent SEC filings by industry members reveal that U.S. producers have sharply increased sales and profitability while improving cash flow and corporate balance sheets. Several companies traced their improved performance to increased export sales and/or the achievement of substantial cost efficiencies in their manufacturing operations. Almost all indicated that they have strengthened their commitment to capital expenditures.

None of the reports have been more glowing than those of

Ingersoll-Rand and Timken, the two largest domestic bearing manufacturers. Ingersoll-Rand's latest 10-Q quarterly financial report (June 30, 1988) stated that sales in its bearings, locks and tools segment increased by 16 percent during both the most recent quarter and the most recent six-month period, with all groups "contributing to the increase". The company also stated that this segment's operating income had increased by seven percent during the most recent six-month period, although such income had increased only marginally during the most recent three-month period. Interestingly, however, the largest domestic producer of ball bearings conceded that its "essentially flat" operating income during the second quarter resulted from "the continuing inefficiencies experienced in maintaining production levels necessary to meet the high demand for Fafnir products". This admission by Ingersoll-Rand demonstrates that the U.S. industry is now producing at full throttle and is strained beyond its capacity.

To amplify on Torrington/Fafnir's ongoing delivery problems, a major U.S. purchaser of bearings -- Caterpillar, Inc. -- testified at a USITC hearing last April that Torrington/Fafnir "cannot meet current demand for commercial ball bearings in a marketplace presently open to imports." Consequently, Caterpillar machines in the field are "literally 'down' awaiting ball bearings," and Caterpillar's production schedules for machines using those bearings are being "disrupted."

Torrington/Fafnir has apparently had similar delivery problems with other important domestic customers. These customers have been quoted lead times of more than 52 weeks. There apparently has been little or no improvement in this area, as Torrington/Fafnir has recently been quoting 50-week delivery times on ball bearings under 30 mm.

The domestic industry's supply problems are not confined to Torrington/Fafnir. Timken too has been having great difficulty supplying its major customers of tapered roller bearings. Based upon information in the trade, Timken recently informed a large automotive customer that there is a major product shortage and, at the same time, attempted to break a contract by instituting a price increase.

These delivery problems are largely corroborated by Ingersoll-Rand's and Timken's latest SEC filings. Ingersoll-Rand stated in its latest 10-Q filing that, during the quarter ending June 30, 1988, its incoming orders -- which "are evenly spread throughout all groups and reflect considerable improvement in the international area" -- totalled $806 million, a 20 percent increase over the second quarter 1987. Further, the company stated that its backlog of orders which it "believed to be firm" stood at approximately $900 million on June 30, 1988, an increase of $128 million over December 31, 1987. Similarly, Timken's 1987 annual report shows that that company's backlog of orders for its domestic and overseas operations was estimated to have been $516.2 million on December 31, 1987, compared to $325 million a year earlier.

The bearing industry's difficulty in meeting its customers' production schedules has been compounded by the industry's long-term problem in obtaining a ready supply of bearing-grade steel at competitive prices. Because of the U.S. Government's policy of protecting the steel industry, the bearing industry has faced higher costs on its raw material imports and on steel purchased from domestic sources, whose prices have risen in response to the higher prices of imported steel. Moreover, a USITC study on the bearing industry found that U.S. bearing producers purchase at least 90 percent of their bearing steel requirements from offshore sources.[1/] Another USITC study concluded that this dependence on imported steel occurs "because the quality grade needed for bearings is not readily available from the U.S. steel industry at prices as low as imported steel."[2/]

With the U.S. steel industry currently operating at a high rate of capacity utilization -- 86.9 percent during the second quarter of 1988 -- domestic steel prices have increased significantly. For example, while the Producer Price Index for capital equipment increased by only 2.5 percent from June 1987 to June 1988, the PPI for the following types of bearing-grade steel showed substantially larger increases over that same period: cold-formed (c.f.) carbon sheet prices increased by 6.4 percent; c.f. carbon strip by 10.4 percent; steel wire by 7.5 percent; and c.f. alloy sheet and strip by 4.7 percent.

[1/] U.S. International Trade Commission, The Effects of Restraining U.S. Steel Imports on the Exports of Selected Steel-Consuming Industries, Inv. No. 332-214, USITC Pub. No. 1788 (Dec. 1985) at 50.

[2/] U.S. International Trade Commission, Competitive Assessment of the U.S. Ball and Roller Bearing Industry, Inv. No. 332-211, USITC Pub. No. 1797 (Jan. 1986) at 95.

The PPI for various forms of stainless steel used in bearings has increased even more, as sharply higher prices of nickel and ferrochrome and the booming demand for fabricated metal products have combined to drive prices upward. The PPI for stainless steel wire increased by 22.1 percent and for stainless c.f. bars by 21.6 percent from June 1987 to June 1988. In addition, users of stainless steel are fearful that a shortage situation may soon develop because of the potential unavailability of needed supplies of ferrochrome, which comes principally from South Africa. These problems in obtaining bearing-grade steel are merely further illustrations of the current boom in domestic bearing production.

Proposals to restrict either foreign investment in the United States or trade in bearings seem misguided in light of the domestic bearing industry's revival and the role foreign investment has played in that revival. Such proposals seem particularly misguided because certain restrictions have already been imposed.

The Department of Defense, for example, recently issued acquisition regulations requiring the purchase of only American-made products in several categories of bearings. This comes on top of an existing procurement regulation which since 1971 has limited DoD purchase of radial ball bearings of 30 mm and under to those of domestic origin. Aggressive implementation by the Defense Department of the recommendations made in the Joint Logistics Commanders Bearing Study will further aid the U.S. bearing industry. U.S. bearing producers are also currently benefitting from antidumping orders on tapered roller bearings requiring importers of Japanese TRBs to post cash deposits of 36.5 percent on a substantial proportion of their entries. Further antidumping and countervailing duty cases currently before the U.S. government may provide additional trade relief to U.S. bearing producers.

The AFBMA Request for National Security Trade Protection

This list of existing restrictions, combined with the renewed health of the U.S. bearing industry, demonstrates that granting further relief would be unjustified and unwise. And yet the Anti-Friction Bearing Manufacturers Association has just requested such additional relief, seeking national security trade protection under section 232 of the Trade Expansion Act of 1962.

Clearly a strong bearing industry is essential to U.S. national security, but the best guarantee of a strong and competitive bearing industry is continued free competition and free trade. In particular, it is important that foreign bearing manufacturers continue to have the freedom to make direct investments in the U.S., investments which have clearly benefitted the U.S. industry and the U.S. industrial base in recent years. It is also important that bearing firms have the freedom to procure raw materials and parts from producers around the globe, thus allowing those bearing firms to base procurement decisions on price, quality and delivery. Only in this way can U.S. bearing producers make procurement decisions which will contribute to the cost-efficient, high-quality production needed to succeed in today's global marketplace.

A competitive U.S. bearing industry -- one which serves U.S. national security needs -- can be sustained only in this environment. Restricting trade, even while citing national security, would be counterproductive. This is particularly true because partial dependence on overseas suppliers of bearings and other essential industrial products would not threaten U.S. national security under the most likely scenarios for an outbreak of hostilities involving the U.S. As Paula Stern and Paul A. London recently wrote, "The trade-offs between domestic self-sufficiency and the costs to the defense budget and the national economy of limiting competition need to be weighed."3/

The Dangers in Attempting to Strengthen National Security by Protecting a U.S. Industry

These examples illustrate the folly of attempting to strengthen national security by restricting imports to protect one industry. Virtually all industries operating in today's interdependent world, including the bearing industry, are characterized by global production, procurement and marketing. U.S. bearing producers have turned to foreign production facilities and foreign sources of parts and raw materials on the basis of such criteria as price, quality, service and delivery;

3/ Paula Stern and Paul A. London, "A Reaffirmation of U.S. Trade Policy" The Washington Quarterly, Autumn 1988, at 70.

use of foreign sites and sources has consequently allowed U.S. bearing producers to improve their international competitiveness in these important criteria. Restraints on trade imposed under the guise of national security relief ignore the need for global production and procurement if the U.S. bearing industry is to remain competitive.

Such trade restraints also ignore the fact that public- and private-sector industrial users of bearings in the U.S. and abroad are increasingly making their purchasing decisions based on the same criteria of price, quality, service and delivery -- without concern for the nationality of the bearing producer. Imposing trade restraints to protect bearing producers could consequently have the unintended effect of harming U.S. companies which are industrial users of bearings, hindering their ability to make cost- and quality-driven sourcing decisions. This in turn could harm these companies' efforts to compete against their counterparts abroad.

In fact, an effort to protect the U.S. bearing industry by imposing trade restraints under section 232 would ignore the international interdependence which is characteristic not only of the bearing industry, but of virtually all industries today. Business relationships are transcending national borders, linking firms without concern for nationality. This growing internationalization is driving businesses in the U.S. and abroad to become more cost-efficient producers of quality products that can compete in a global marketplace. Restricting trade to protect one industry ignores the reality of this global economic interdependence.

Trade policies which attempt to deal in isolation with one industry or product most often result in the creation of a domestic industry dependent on trade restraints. This protected industry consequently does not become competitive on the international stage. And such trade policies also harm companies which are dependent on the protected industry's products. Such barriers can thus be counterproductive, weakening the economy of the United States and actually undermining American national security. To again quote Paula Stern and Paul A. London, "The United States should not allow national security to be defined by industries and interests seeking shelter from competition."[4]

Economic Strength As the Key to National Security

The only real guarantee of American national security is a healthy American economy. Not coincidentally, such a strong economy is also the best prescription for a healthy U.S. bearing industry.

Although major structural problems still beset our economy -- such as the budget and trade deficits or the relative obsolescence of much of our infrastructure -- The U.S. is making important strides to overcome these problems. This is evident in the improvement of the so-called "twin deficits, the sustained rise in American manufacturing productivity in recent years and the broad emphasis throughout American society on improving our international competitiveness.

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[4] Stern and London at 69.

Much of the heightened awareness of the need for improvement has already been translated into concrete results. Though the six straight years of American economic growth can be attributed to a myriad of factors, much of that growth clearly derives from U.S. industries' steps to adapt to a sharply altered economic environment. This adjustment is reflected in such growing efficiencies throughout the U.S. manufacturing base as the 83.7 percent rate of production capacity utilization posted in July -- the highest rate in more than eight years -- and the continuing high level of operating profits. This has been accompanied by a strong commitment to increased expenditures for plant and equipment, which has been fueled in part by an export boom.

This broad economic revival has clearly strengthened U.S. national security. More specifically, the U.S. bearing industry is sharing in this long-term improvement in the American economy. It therefore makes no sense at all to consider the imposition of import restrictions for a growing industry whose health is inextricably linked with that of the broader economy.

U.S. Assets Held By Japan and By All Countries,* and Japan's Share of the Total,
By Selected Type of Investment At Yearend, 1983-1987 and June 30, 1988
(in Millions of Dollars)

	1983	1984	1985	1986	1987	June 30, 1988
Direct Investment:						
Japan	11,336	14,817	19,313	26,824	33,361	NA
All Countries	137,061	159,571	184,615	220,414	261,927	NA
Japan's Share of Total (%)	8.3	9.3	10.5	12.2	12.7	NA
U.S. Securities, Other Than U.S. Treasuries						
Japan	2762	4163	10,503	25,042	37,868	NA
All Countries	114,710	128,201	206,628	308,773	344,363	NA
Japan's Share of Total (%)	2.4	3.2	5.1	8.1	11.0	NA
U.S. Treasury, Short-Term Securities						
Japan	7410	7787	5246	14,263	20,308	22,577
All Countries	68,669	75,839	68,784	90,272	101,794	107,649
Japan's Share of Total (%)	10.8	10.3	7.6	15.8	20.0	21.0
Total, Foreign Assets in U.S.						
Japan	50,046	64.141	102,817	156,176	194,031	NA
All Countries	787,611	886,448	1,061,253	1,340,670	1,536,040	NA
Japan's Share of Total (%)	6.4	7.2	9.7	11.6	12.6	NA

Source: All data except short-term Treasury securities are compiled from data published by the Survey of Current Business, U.S. Department of Commerce/Bureau of Economic Analysis, in the annual review entitled "The International Investment Position of the United States," June 1985, 1986, 1987 and 1988 issues. Data on short-term U.S. Treasury security holdings are compiled from data published in the U.S. Treasury Bulletin, Table CM-I4, "Total Libabilities, By Type and By Country."

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* Includes Assets held by both private parties and institutions ("official" holdings).

Statement by H. William Tanaka
Tanaka Ritger & Middleton
In Response to Testimony by Augustine "Gus" Sperrazza before the Senate Small Business Committee, September 8, 1988

The testimony given today by Mr. Sperrazza must be viewed in the context of his business practices.

The troubles of his company -- Pacamor/Kubar are a matter of public record. After less than a year of operation, funded in large part by an SBA loan, Pacamor/Kubar is now currently in Chapter 11 voluntary bankruptcy in federal court in New York. Sperrazza's own disclosure statement, on file in that proceeding, states that Kubar's "start-up operations were dismal," production problems were "rampant," and the company absymally failed to meet any of its production goals.

In fact, Kubar managed to produce only a day-and-a-half's capacity of bearings over five months. The companies themselves attribute their problems to a "lack of working capital" and "wrong management decisions"; as one example, different

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departments of Kubar "were producing parts that were not even matched to the types of bearings scheduled for final assembly" in another division.[1]

Less than 10 months after start-up in 1985, Pacamor/Kubar defaulted on all its loans. A year later, in October 1986, Pacamor and Kubar sought protection from their creditors in the Chapter 11 proceeding. According to court papers filed by the International Trade Administration (a major creditor), Pacamor and Kubar management in the period between default and the Chapter 11 proceeding "operated the companies in complete disregard of their obligations" to their numerous creditors. Instead of paying the companies' bills, corporate monies were dissipated by nearly $100,000 in travel and entertainment expenses for fiscal 1986, luxury cars for company officers and their families, and $77,000 in "consulting fees" to a family member with no apparent business duties.[2]

At this point, Pacamor/Kubar's resources are woefully inadequate even to begin discharging their debts to their secured creditors -- including two agencies of the U.S. government, the ITA and the Small Business Administration. The over 200 unsecured Pacamor/Kubar creditors -- are left totally in the lurch.

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[1] Pacamor/Kubar Consolidated Disclosure Statement, filed in Civil Actions. Nos. 86-11477, 86-11478 (N.D.N.Y., October 19, 1987), at p. 19.

[2] International Trade Administration Appellant's Brief (Sept. 1987) at 3.

Progressive and well-managed U.S. bearing companies are themselves becoming internationalized and are taking full advantage of the strengthening of the U.S. economy. They need no relief. It makes no sense at all to give an operation like Pacamor/Kubar a free ride in the name of "national security."

US. DOC, ITA Brief
filed with U.S. Bankruptcy Court, albany, N.Y.

III. STATEMENT OF THE CASE

Background

On or about December 14, 1984, Appellant International Trade Administration, an agency of the United States Department of Commerce ("ITA"), made a direct working capital loan to Appellee Kubar Bearings, Inc. ("Kubar"), a manufacturer of precision bearings, in the principal amount of $500,000 ("the ITA loan"). As collateral for this loan, Kubar gave ITA a first position security interest on the accounts receivable and inventories[1], and a second position security interest in the machinery and equipment, furniture and fixtures and other capital assets and a second position security interest in the leasehold mortgage on Kubar's manufacturing facility located in the Rensselaer Technology Park, Troy, New York. Kubar also gave ITA an assignment of the leasehold interest covering the 99-year ground lease with Rensselaer Polytechnic Institute. As further collateral for the loan, Kubar's parent company, Pacamor Bearings, Inc. ("Pacamor")[2] gave ITA an assignment of a $2,050,000 keyman life insurance policy on the life of its President, Augustine J. Sperazza, Jr. and Pacamor's full corporate guaranty. Augustine J. Sperazza, Jr. personally guaranteed the ITA loan.[3] Affidavit of Robert E. Badger, ("Badger Aff't"), paragraph 2.

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[1] Inventories includes raw materials, finished goods and work in process.

[2] Pacamor is an importer of bearings, and has no manufacturing ability outside of its ownership of Kubar. Pacamor's primary assets are its inventory and accounts receivable, on which Wells Fargo Bank holds a first position security interest.

In November, 1985, less than one year after the December, 1984 loan closing, Kubar defaulted on the ITA loan and all its other indebtedness. Between November, 1985, and October, 1986, ITA, Kubar, and Pacamor met with the companies' major creditors, Wells Fargo Bank ("Wells"), Home & City Savings Bank ("HCSB"), Union National Bank ("UNB"), and certain Small Business Investment Corporations ("SBICs") in an attempt to reach an agreement on the restructure of Kubar's and Pacamor's debt. These negotiations were unsuccessful. Badger Aff't, paragraph 3.

During the time of the negotiations, Kubar and Pacamor management operated the companies in complete disregard of the companies' obligations to their creditors.[4] Kubar sales and production schedules repeatedly fell far short of their optimistic levels. Kubar has never achieved profitability. During Kubar's crucial start-up period, from January, 1985 until default in November, 1985, Kubar experienced cost overruns of 40 percent more than the budgeted amount and incurred significant labor and overhead costs with production averages of 3,000 units per month. Badger Aff't, paragraph 4.

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[3] Mr. Sperazza has also personally guaranteed virtually all of the loans made to Kubar and Pacamor. Because of this, ITA believes that Mr. Sperazza will be unable to satisfy his guarantee obligations to ITA.

[4] During 1985 and 1986, Pacamor paid a total of $77,000 in "consulting fees" to the companies' preferred stockholder, Augustine Sperazza, Sr. Mr. Sperazza is a physician. ITA believes that these payments were constructive dividends, paid for no consideration whatsoever, in violation of Kubar's loan agreement with ITA.

During this period, Kubar's president, Augustine J. Sperazza, Jr. collected a salary of $150,000, reduced in 1986 to $135,000.00. Mr. Sperazza drives a Mercedes Benz automobile at corporate expense. His wife drives a Jaguar, also at corporate expense despite the fact that Mrs. Sperazza performs no services for either company. Automobile expenses for fiscal 1985 totaled $66,000 and for 1986 totaled $61,000.

For fiscal year 1985, the companies spent $146,462.00 in travel and entertainment expenses. During fiscal year 1986, while the companies were not paying their secured creditors, the companies incurred travel and entertainment expenses of $94,442.00.

On October 7, 1986, Kubar and Pacamor filed for Chapter 11 relief, in response to notice from Wells that it would notify Pacamor's customers to begin direct payments to Wells if the companies did not file. From October 7, 1986 until March 2, 1987, Kubar continued to operate its manufacturing business in the same manner as it had from November, 1985 until October, 1986, by using ITA's cash collateral. Kubar continued to produce between 80,000 and 100,000[5] bearings per month, as it had during the time preceding its Chapter 11 filing. At the time of filing, Kubar owed ITA $543,067.16, with interest continuing to accrue at a daily rate of $155.475960.

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[5] Based on financial information obtained in December, 1986, ITA believes that Kubar must produce at least 100,000 bearing units per month to achieve no net operating loss.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK
- x

In re	:	Chapter 11
PACAMOR BEARINGS, INC.,	:	Case No.
Debtor.	:	

- x

LIST OF CREDITORS OF PACAMOR BEARINGS, INC.

Attached is the preliminary list of creditors of Pacamor Bearings, Inc. Debtor does not concede the validity or enforceability of any listed claim and reserves the right to object to all claims.

New York, New York
October 23, 1986

PACAMOR BEARINGS, INC.,
Debtor-in-Possession

By: ______________________

WHITMAN & RANSOM
Attorneys for Debtor

By: ______________________
200 Park Avenue
New York, New York 10166
(212) 351-3000

5424T

PacAmOr Bearings, Inc.
List of Secured Creditors [1]
10/7/86

Wells Fargo Bank Attn: Ms. Christiana Creekpaum Vice President Loan Adjustment Dept. P.O. Box 63400 525 Market Street San Francisco, CA 94163	$ 3,719,447.00
PNC Capital Corp. Attn: Mr. David M. Hillman Executive Vice President Pittsburgh National Building 19th Floor 5th Avenue & Wood Street Pittsburgh, PA 15222	$ 350,000.00
M & T Capital Corp. Attn: Mr. Joseph Parloto President One M & T Plaza Buffalo, NY 14240	$ 350,000.00
Essex Management Inc. Attn: Mr. Mark R. Littell P.O. Box 4307 Upper Montclair, NJ 07043	$ 350,000.00
	$ 4,769,447.00

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[1] Principle balances only - does not include accrued interest.

PacAmOr Bearings, Inc.
Accounts Payable
10/7/86

	AMOUNT
A.B. Dick Company P.O. Box 40,000 - Dept. 196 Hartford, CT	$ 89.88
ADR Ultrasound 734 W. Alexander Drive Tempe, AZ	956.75
Airborne Express P.O. Box 91001 Seattle, WA 98111	14.00
Alling & Cory P.O. Box 60 Utica, NY 13503	978.14
Alliance Bearing 14745 Arminta Street Van Nuys, CA 91402	12,663.12
American Express P.O. Box 1270 Newark, NJ 07101	526.62
Antifriction Bearings 740 15th Street NW Lockbox Washington D.C.	520.00
APA Transport P.O. Box 831 North Bergen, NJ	51.74
Armory Garage 926 Central Avenue Albany, NY 12205	115.99
AST Servo 115 Main Road (U.S. Route 202) Montville, NJ	15,949.04
AVIS P.O. Box 470407 Dallas, TX	414.30

PacAmOr Bearings, Inc.
Accounts Payable
10/7/86

	AMOUNT
Burmah-Castrol Bray Products Div. Dept. #1996 SCF Pasadena, CA	$ 787.74
Business Organization 2774 West Lake Road Skaneatiles, NY	3093.05
Campana Santora Travel 73 Fourth Street Troy, NY 12180	1428.50
Capital District Personnel Assoc. 15 Melissa Ct. Albany, NY 12205	35.00
Clear View Bag Co. P.O. Box 11160 Albany, NY 12211	119.84
Country True Value 217 N. Greenbush Road, Rte. 4 Troy, NY 12180	83.02
Columbian Mutual 1 Columbian Mutual Plaza Binghamton, NY	1004.22
D.J. Moore Advertising Inc. Star Plaza West Guilderland, NY	4163.00
Doctor Barr 1736 Western Avenue Albany, NY 12203	554.00
Dorsey & Whitney 2200 First Bank Place Minneapolis, MN	221.50
Dow Jones Service P.O. Box 71139 Chicago, IL 60694	134.82

PacAmOr Bearings, Inc.
Accounts Payable
10/7/86

	AMOUNT
Drawing Board P.O. Box 38520 Louisville, KY 40233	$ 652.11
DuPont Co. P.O. Box 360708M Pittsburgh, PA 15250	1912.03
Easton Press 47 Richards Avenue Norwalk, CT 06857	37.50
Federal Express Corp. P.O. Box 727 Dept. A Memphis, TN 38194	282.92
Foster Medical Supply P.O. Box 12211 Albany, NY 12212	60.13
FTC Communications P.O. Box 13382 Church Street Station New York, NY 10249	329.62
Gannett Rochester P.O. Box 22077 Rochester, NY 14673	283.90
International Herald Tribune 181 Avenue Charles-De-Gaulle 92521 Nevilly Cedex France	350.00
Julius Kraft Co. P.O. Box 918 Auburn, NY 13021	180.35
Keeler 111 Troy-Schenectady Road Latham, NY 12110	218.78
Lawrence A. Kotlow D.D.S. 7 Fuller Road Albany, NY 12203	117.00

PacAmOr Bearings, Inc.
Accounts Payable
10/7/86

	AMOUNT
Latham Motors P.O. Box 699 Latham, NY	$ 463.56
Lazare 144 Wolf Road Albany, NY 12205	117.70
Lombardo's 121 Madison Avenue Albany, NY 12202	280.49
Lubricant Packaging P.O. Box 246 Middletown, NY	64.76
Edward J. Martin 246 New Scotland Avenue Albany, NY 12208	40.00
Micro Miniature Bearing 12 Progress Place Jackson, NJ 08527	21,081.40
Mico Office Supplies P.O. Box 5007 Albany, NY 12205	1259.48
M.I.S. Associates 52 Grant Hill Court Clifton Park, NY 12065	127.50
Monarch Marking P.O. Box 1815 Dayton, OH 45401	877.91
Mobile Air Transport Box 219 Latham, NY 12110	76.30
Motor Carrier Audit P.O. Box 57584 Dallas, TX 75207	108.54
Monodnock Ledger Box 36, 26 Main Street Peterborough, NH 03458	94.40

PacAmOr Bearings, Inc.
Accounts Payable
10/7/86

	AMOUNT
M & T Capital Corp. One M & T Plaza Buffalo, NY 14240	$ 704.03
Nationwide Transport P.O. Box 2561 Newark, NJ 07114	80.73
N.Y. Telephone P.O. Box 1100 Albany, NY 12250	3033.39
N.Y.S. Income Tax P.O. Box 1970 Albany, NY 12201	767.17
The New York Times P.O. Box 15390 Newark, NJ 07192	75.32
Offi-Serv 152 Main Street Ravena, NY 12143	904.58
Olivetti USA Attn: Diana Yatsko P.O. Box 660230 Dallas, TX 75266	22,750.00
Overnite Transportation P.O. Box 1216 Richmond, VA 23209	240.94
Pitney Bowes P.O. Box 12070 Albany, NY 12212	67.41
Printfilm Ltd. P.O. Box 11-160 Albany, NY 12211	975.48
Preston Trucking Co. 151 Easton Boulevard Preston, MD 21655	94.48

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	AMOUNT
Purolator Courier P.O. Box 4786 GMF Taft Road Syracuse, NY 13221	$ 28.50
R.C.A. Global P.O. Box 8068-859 Philadelphia, PA 19770	1129.85
Jeffrey A. Schumacker M.D. 747 Madison Avenue Albany, NY 12208	150.00
Walter Snyder Printer 691 River Street Troy, NY 12180	1500.00
Spectrum Products 17 Dove Street Troy, NY 12210	597.36
Standard Register Co. P.O. Box 14506 Cincinnati, OH 45263	813.22
Star Gazette 201 Baldwin Street Elmira, NY 14902	81.18
SUNY Research Foundation 4500 Old Vestal Road Binghamton, NY	405.86
Superintendant of Documents U.S. Gov't Printing Office Washington, DC 20402	173.00
Tate, Bishko & Rutham 1698 Central Avenue Albany, NY 12205	8226.81

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	AMOUNT
Tri-State Laundries P.O. Box 4145 Utica, NY 13504	$ 218.80
Troy Light Co. 85 Congress Street Troy, NY 12180	51.17
Tri-City Racquet Club 944 New Loudon Road Latham, NY 12110	166.67
UAC Airfreight 147-02 181st Street Jamacia, NY	2360.24
United Parcel Service P.O. Box 207 Liverpool, NY 13088	244.63
U.S. Customs Service P.O. Box 100189 Atlanta, GA 30384	674.35
U.S. News & World Report P.O. Box 55906 Boulder, CO 80321-5906	29.00
Vincent Trucking P.O. Box 290 Berlin, NY 12022	68.45
Western Union P.O. Box 7777 W-6675 Philadelphia, PA 19175	178.05
Wolferts Roost Van Rensselaer Blvd. Albany, NY 12204	242.11
Xerox Corporation Xerox Square 837 Rochester, NY	613.81

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	AMOUNT
J. R. Zagame Assoc. 1001 Prince Street Suite 116 Alexandria, VA	$ 294.75
Union National Bank 80 State Street Albany, NY 12201	344,278.15
Sapporo Precision South 1 East Chou-ku Sapporo, 060 Japan	167,221.73
Nakai Bearings No. 12-3-2 Cho Hamadero, Ishizucho-Higashi Sakai, Osaka 592 Japan	164,428.71
Wada Seiko Co., Ltd. ✓ 3-11, 2-Cho Hokusho-cho, Sakai City Osaka, Japan	8433.74
AT & T Consumer Products Div. P.O. Box 1779 Newark, NJ 07185-1779	30.36
Bearing, Seals & Gears 321 26th Street Hemosa Beach, CA 90254	948.08
Brosey Associates P.O. Box 157 Jupiter, FL 33458	103.27
EDP Associates 10313 N. Scottsdale Road Scottsdale, AZ 85253	119.12
Dr. Louis Gagliardi 2020 Western Avenue Albany, NY 12203	45.00
Harders Express Main Office Route 9M Claverack, NY 12513	576.59

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	AMOUNT
Honshin Air Cargo USA Inc. J.A.F. P.O. Box 1671 New York, NY 10116	$ 79.52
Hertz Corporation P.O. Box 26141 Oklahoma City, OK 73126	117.25
Key Bank P.O. Box 1897 Albany, NY 12205	345.13
Lane Press 11 Kairness Street Albany, NY 12201	117.49
Mobil P.O. Box 5969 N. Suburban, IL 60197-5969	248.64
Norstar Leasing Services P.O. Box 1667 Albany, NY 12201	226.13
Peterson Enterprises 480 Rice Creek Blvd. Minneapolis, MN 55432	915.81
Probe Electronics 100 W. Higgins Road Room 205 Park Ridge, IL 60068	3867.57
Shell Oil Co. P.O. Box 925 Tulsa, OK 74184	113.04
Shanahan & Associates 6920 Wildflower Trail Cincinnati, OH 45230	549.26
Sweetheart Flower Shop 42 3rd Street Troy, NY 12180	16.05

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	AMOUNT
Vermont Container Corp. P.O. Box 648 Bennington, VT 05201	$1358.09
Wang Laboratories Attn: Linda Romano 67 South Bedford Street Burlington, MA 01803	433.35
Danker Florist Inc. 658 Central Avenue Albany, NY 12206	41.45
Deluxe Computer Forms P.O. Box 64046 St. Paul, MN 55164-D046	71.21
Stephen H. Fox 9959 Adletta Blvd. #902 Dallas, TX 75243	820.98
NYS Businessmans Group Inc. P.O. Box 189 Delmar, NY 12054	728.33
Richard Olson 32 Michigan Road Jaffrey, NH 03452	147.95
John R. Ruggeri 7 Park Circle Drive Menands, NY 12204	603.80
Whitman & Ransom 522 Fifth Avenue New York, NY 10036	10,392.01
Smith & Company P.O. Box 283A Nassua, NY 12123	750.00
TOTAL	$ 828,989.80